# 1st VALLEY BANK, INC., A DEVELOPMENT BANK

**Vamenta Blvd., corner Lirio Street, Carmen**
**Cagayan de Oro City**

## STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR ANNUAL INCOME TAX RETURN

The Management of **1st Valley Bank, Inc., A Development Bank** (the Bank)is responsible for all information and representations contained in the Annual Income Tax Return for the year ended December 31, 2019. Management is likewise responsible for all information and representations contained in the financial statements accompanying the Annual Income Tax Return covering the same reporting period. Furthermore, the Management is responsible for all information and representations contained in all the other tax returns filed for the reporting period, including, but not limited, to the value-added tax and/or percentage tax returns, withholding tax returns, documentary stamp tax returns, and any and all other tax returns.

In this regard, the Management affirms that the attached audited financial statements for the year ended December 31, 2019 and the accompanying Annual Income Tax Return are in accordance with the books and records of the Bank and is complete and correct in all material respects. Management likewise affirms that:

(a) the Annual Income Tax Return has been prepared in accordance with the provisions of the National Internal Revenue Code, as amended, and pertinent tax regulations and other issuances of the Department of Finance and the Bureau of Internal Revenue;

(b) any disparity of figures in the submitted reports arising from the preparation of financial statements pursuant to financial accounting standards and the preparation of the income tax return pursuant to tax accounting rules has been reported as reconciling items and maintained in the Bank's books and records in accordance with the requirements of Revenue Regulations No.8-2007 and other relevant issuances;

(c) the Bank has filed all applicable tax returns, reports and statements required to be filed under Philippine tax laws for the reporting period, and all taxes and other impositions shown thereon to be due and payable have been paid for the reporting period, except those contested in good faith.

Signature : ____________________
**MR. NELSON L. TE**
Chairman of the Board

Signature : ____________________
**ATTY. NICOLAS J. LIM**
President

Signature : ____________________
**MS. ANAVIC A. SARSALE**
Finance Head

Signed this 26th day of June 2020.

P&A
Grant Thornton
An instinct for growth™

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# Report of Independent Auditors

**The Board of Directors**
**1st Valley Bank, Inc., A Development Bank**
Vamenta Blvd., corner Lirio Street, Carmen
Cagayan de Oro City

## Report on the Audit of the Financial Statements

### *Opinion*

We have audited the financial statements of 1st Valley Bank, Inc., A Development Bank (the Bank), which comprise the statements of financial position as at December 31, 2019 and 2018, and the statements of comprehensive income, statements of changes in capital funds 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, 2019 and 2018, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards (PFRS).

### *Basis for Opinion*

We conducted our audits in accordance with Philippine Standards on Auditing (PSA). Our responsibilities under those standards are further described in the *Auditors' 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 audits 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.

- 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 auditors' 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 auditors' 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.

**PUNONGBAYAN & ARAULLO**

By: **Ramilito L. Nañola**
Partner

CPA Reg. No. 0090741
TIN 109-228-427
PTR No. 7333698, January 3, 2019, Makati City
SEC Group A Accreditation
Partner - No. 0395-AR-3 (until May 19, 2019)
Firm - No. 0002-FR-5 (until Mar. 26, 2021)
BIR AN 08-002511-19-2018 (until Jan. 25, 2021)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Jul. 24, 2021)

March 20, 2019

- 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 auditors' 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 auditors' 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 Other Legal and Regulatory Requirements

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information for the year ended December 31, 2019 required by the Bangko Sentral ng Pilipinas (BSP) under BSP Circular 1074 and by the Bureau of Internal Revenue under Revenue Regulations (RR) 15-2010 as disclosed in Notes 24 and 25, respectively, to the financial statements is presented for purposes of additional analysis and is not required part of the basic financial statements prepared in accordance with PFRS. Such supplementary information is the responsibility of management. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

**PUNONGBAYAN & ARAULLO**

By: **Ramilito L. Nañola**
Partner

CPA Reg. No. 0090741
TIN 109-228-427
PTR No. 8116551, January 2, 2020, Makati City
SEC Group A Accreditation
Partner - No. 0395-AR-4 (until Sept. 16, 2022)
Firm - No. 0002-FR-5 (until Mar. 26, 2021)
BIR AN 08-002511-19-2018 (until Jan. 25, 2021)
Firm's BOA/PRC Cert. of Reg. No. 0002 (until Jul. 24, 2021)

March 18, 2020

**1[st] VALLEY BANK, INC., A DEVELOPMENT BANK**
**STATEMENTS OF FINANCIAL POSITION**
**DECEMBER 31, 2019 AND 2018**
***(With Corresponding Figures as of January 1, 2018)***
***(Amounts in Philippine Pesos)***

| | Notes | December 31, 2019 | December 31, 2018 (As Restated – see Note 2) | January 1, 2018 (As Restated – see Note 2) |
|---|---|---|---|---|
| **RESOURCES** | | | | |
| **CASH AND OTHER CASH ITEMS** | 6 | **P 122,965,051** | P 74,911,233 | P 133,420,224 |
| **DUE FROM BANGKO SENTRAL NG PILIPINAS** | 6 | **291,928,290** | 370,499,440 | 388,796,188 |
| **DUE FROM OTHER BANKS** | 6 | **1,019,769,230** | 588,053,970 | 424,916,385 |
| **INVESTMENT SECURITIES AT AMORTIZED COST** - Net | 7 | **294,723,281** | 529,700,546 | - |
| **HELD-TO-MATURITY INVESTMENTS** - Net | 7 | **-** | - | 334,655,592 |
| **LOANS AND DISCOUNTS** - Net | 8 | **8,042,695,371** | 6,863,642,051 | 5,431,041,444 |
| **BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT** - Net | 9 | **198,583,391** | 110,193,591 | 110,249,673 |
| **RIGHT-OF-USE ASSETS** | 10 | **162,459,904** | - | - |
| **INVESTMENT PROPERTIES** | 11 | **179,711,202** | 139,528,534 | 110,770,552 |
| **OTHER RESOURCES** - Net | 12 | **124,245,698** | 390,849,959 | 236,441,469 |
| **TOTAL RESOURCES** | | **P 10,437,081,418** | P 9,067,379,324 | P 7,170,291,527 |
| **LIABILITIES AND CAPITAL FUNDS** | | | | |
| **DEPOSIT LIABILITIES** | 13 | **P 5,293,764,257** | P 4,158,344,512 | P 4,269,860,953 |
| **BILLS PAYABLE** | 14 | **2,085,627,068** | 2,461,508,766 | 808,892,308 |
| **LEASE LIABILITIES** | 10 | **169,239,833** | - | - |
| **ACCRUED EXPENSES AND OTHER LIABILITIES** | 15 | **452,556,562** | 508,167,986 | 397,369,623 |
| Total Liabilities | | **8,001,187,720** | 7,128,021,264 | 5,476,122,884 |
| **CAPITAL FUNDS** | 16 | **2,435,893,698** | 1,939,358,060 | 1,694,168,643 |
| **TOTAL LIABILITIES AND CAPITAL FUNDS** | | **P 10,437,081,418** | P 9,067,379,324 | P 7,170,291,527 |

*See Notes to Financial Statements.*

**1[st] VALLEY BANK, INC., A DEVELOPMENT BANK**
**STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**
***(With Comparative Figures as of December 31, 2018***
***(Amounts in Philippine Pesos)***

| | Notes | 2019 | 2018 (As Restated – see Note 2) |
|---|---|---|---|
| **INTEREST INCOME ON:** | | | |
| Loans and discounts | 8 | P 1,042,726,647 | P 930,066,834 |
| Investment securities at amortized cost | 7 | 28,236,703 | 17,327,346 |
| Due from other banks | 6 | 930,330 | 896,050 |
| | | 1,071,893,680 | 948,290,230 |
| **INTEREST EXPENSE ON:** | | | |
| Bills payable | 14 | 140,068,463 | 96,832,415 |
| Deposit liabilities | 13 | 131,513,092 | 134,340,364 |
| Others | 10, 18 | 9,529,488 | 1,404,552 |
| | | 281,111,043 | 232,577,331 |
| **NET INTEREST INCOME** | | 790,782,637 | 715,712,899 |
| **IMPAIRMENT LOSSES** - Net | 8, 12 | 2,481,321 | 137,830,191 |
| **NET INTEREST INCOME AFTER IMPAIRMENT LOSSES** | | 788,301,316 | 577,882,708 |
| **OTHER INCOME** | 17 | 441,227,011 | 415,768,533 |
| **OTHER EXPENSES** | 17 | 692,798,227 | 645,069,088 |
| **NET PROFIT BEFORE TAX** | | 536,730,100 | 348,582,153 |
| **TAX EXPENSE** | 19 | 161,695,329 | 99,193,823 |
| **NET INCOME** | | 375,034,771 | 249,388,330 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | | |
| **Items that will not be reclassified subsequent to profit or loss:** | | | |
| Actuarial gain (loss) on remeasurements of defined benefit plan | 18 | 2,235,224 | ( 6,584,444 ) |
| Share in other comprehensive income of associate | 12 | - | 585,997 |
| Tax income (expense) | 19 | ( 670,567 ) | 1,799,534 |
| | | 1,564,657 | ( 4,198,913 ) |
| **TOTAL COMPREHENSIVE INCOME** | | P 376,599,428 | P 245,189,417 |

***See Notes to Financial Statements.***

## 1st VALLEY BANK, INC., A DEVELOPMENT BANK
## STATEMENTS OF CHANGES IN CAPITAL FUNDS
## FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018
*(Amounts in Philippine Pesos)*

| | Capital Stock (see Notes 1, 2 and 16) | Stock Dividends Distributable (see Note 16) | Other Reserves (see Notes 1 and 2) | Remeasurements of Defined Benefit Plan (see Note 18) | Surplus (see Note 2) | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2019 | | | | | | |
| As previously reported | P 766,465,080 | P - | P 317,239,922 | (P 11,762,476) | P 938,501,918 | P 2,010,444,444 |
| Effect of change in accounting policy | - | - | - | - | ( 71,086,384) | ( 71,086,384) |
| As restated | 766,465,080 | - | 317,239,922 | ( 11,762,476) | 867,415,534 | 1,939,358,060 |
| Issuance of shares to effect the merger | 32,317,110 | - | 87,619,100 | - | - | 119,936,210 |
| General loan loss provision | - | - | 58,761,160 | - | ( 58,761,160) | - |
| Total comprehensive income for the year | - | - | - | 1,564,657 | 375,034,771 | 376,599,428 |
| **Balance at December 31, 2019** | **P 798,782,190** | **P -** | **P 463,620,182** | **(P 10,197,819)** | **P 1,183,689,145** | **P 2,435,893,698** |
| Balance at January 1, 2018 | | | | | | |
| As previously reported | P 638,720,900 | P 127,744,180 | P 317,239,922 | (P 7,153,365) | P 670,105,031 | P 1,746,656,668 |
| Effect of change in accounting policy | - | - | - | - | ( 52,488,025) | ( 52,488,025) |
| As restated | 638,720,900 | 127,744,180 | 317,239,922 | ( 7,153,365) | 617,617,006 | 1,694,168,643 |
| Total comprehensive income (loss) for the year | - | - | - | ( 4,609,111) | 249,798,528 | 245,189,417 |
| Distribution of stock dividends | 127,744,180 | ( 127,744,180) | - | - | - | - |
| Balance at December 31, 2018 | P 766,465,080 | P - | P 317,239,922 | (P 11,762,476) | P 867,415,534 | P 1,939,358,060 |

*See Notes to Financial Statements.*

**1st VALLEY BANK, INC., A DEVELOPMENT BANK**
**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**
***(Amounts in Philippine Pesos)***

| | Notes | 2019 | 2018 (As Restated – see Note 2) |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net profit before tax | | P 536,730,100 | P 348,582,153 |
| Adjustments for: | | | |
| Interest income | 6, 7, 8 | ( 1,071,893,680 ) | ( 948,290,230 ) |
| Interest expense | 10, 13 ,14, 18 | 281,111,043 | 232,577,331 |
| Depreciation and amortization | 9, 10, 11, 12 | 58,930,727 | 39,318,212 |
| Gain on fair valuation of previously held interest in an associate | 12 | ( 6,564,211 ) | - |
| Loss (gain) on disposal of investment properties | 11 | ( 5,718,301 ) | 3,575,015 |
| Equity share in net income of an associate | 12 | ( 5,583,558 ) | ( 410,197 ) |
| Impairment losses - net | 8, 12 | 2,481,321 | 137,830,191 |
| Operating loss before working capital changes | | ( 210,506,559 ) | ( 186,817,525 ) |
| Increase in loans and discounts | | ( 287,982,537 ) | ( 1,572,571,630 ) |
| Decrease in investment properties | | 42,401,961 | 81,137,041 |
| Decrease (increase) in other resources | | 316,698,799 | ( 166,500,534 ) |
| Increase (decrease) in deposit liabilities | | 402,250,947 | ( 115,143,313 ) |
| Increase (decrease) in accrued expenses and other liabilities | | ( 354,434,780 ) | 105,967,278 |
| Cash used in operations | | ( 91,572,169 ) | ( 1,853,928,683 ) |
| Interest received | | 1,031,776,581 | 884,097,056 |
| Interest paid | | ( 302,847,494 ) | ( 203,705,891 ) |
| Cash paid for income taxes | | ( 92,390,294 ) | ( 115,938,182 ) |
| Net Cash From (Used in) Operating Activities | | 544,966,624 | ( 1,289,475,700 ) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Proceeds from maturity of investment securities at amortized cost | 7 | 489,984,860 | 314,995,793 |
| Net cash transferred through the merger | 1 | 234,679,836 | - |
| Additions to investment securities at amortized cost | 7 | ( 164,998,019 ) | ( 504,984,078 ) |
| Proceeds from settlement of advances to an associate | 12 | 58,928,187 | 74,653,886 |
| Acquisition of bank premises, furniture, fixtures and equipment | 9 | ( 55,250,819 ) | ( 35,186,166 ) |
| Additions to advances to an associate | 12 | ( 52,715,635 ) | ( 86,017,152 ) |
| Proceeds from disposal of bank premises, furniture, fixtures and equipment | 9 | 64 | 28,805 |
| Advance payment made for purchase of an acquiree | 1 | - | ( 40,300,000 ) |
| Net Cash From (Used in) Investing Activities | | 510,628,474 | ( 276,808,912 ) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Settlements of bills payables | 14 | ( 2,472,464,148 ) | ( 761,300,072 ) |
| Additions to bills payables | 14 | 1,838,729,366 | 2,413,916,530 |
| Payments of lease liabilities | 10 | ( 20,662,388 ) | - |
| Net Cash From (Used in) Financing Activities | | ( 654,397,170 ) | 1,652,616,458 |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS** | | 401,197,928 | 86,331,846 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | | | |
| Cash and other cash items | | 74,911,233 | 133,420,224 |
| Due from Bangko Sentral ng Pilipinas (BSP) | | 370,499,440 | 388,796,188 |
| Due from other banks | | 588,053,970 | 424,916,385 |
| | | 1,033,464,643 | 947,132,797 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | | | |
| Cash and other cash items | | 122,965,051 | 74,911,233 |
| Due from BSP | | 291,928,290 | 370,499,440 |
| Due from other banks | | 1,019,769,230 | 588,053,970 |
| | | P 1,434,662,571 | P 1,033,464,643 |

**Supplemental Information on Noncash Investing and Financing Activities:**

(a) On December 27, 2019, the merger of the Bank has been approved by the Securities and Exchange Commission, with total goodwill amounting to P12,376,524 and gain on revaluation of previously-held investments amounting to P6,564,211 (see Notes 1 and 12).

(b) As of January 1, 2019, the Bank recognized right-of-use assets and lease liabiliies amounting to P85,816,114 (see Notes 2 and 10). During the year, additional right-of-use assets and lease liabilities were recognized amounting to P73,283,101 (see Note 10).

*See Notes to Financial Statements.*

**1ST VALLEY BANK, INC., A DEVELOPMENT BANK**
**NOTES TO FINANCIAL STATEMENTS**
**DECEMBER 31, 2019 AND 2018**
***(Amounts in Philippine Pesos)***

## 1. CORPORATE INFORMATION

### *1.1 Incorporation and Operations*

1st Valley Bank, Inc., A Development Bank (the Bank) is a development bank, which was registered with the Philippine Securities and Exchange Commission (SEC) on April 19, 2013 and started commercial operations on August 1, 2013. The Bank was organized for the purpose of the consolidation of two rural banks namely: 1st Valley Bank, Inc., A Rural Bank (1VBRB) and Community Rural Bank of Clarin (Misamis Occidental), Inc. (Clarin). Consequently, the Bank acquired all the assets and assumed all the liabilities of 1VBRB and Clarin in exchange for the Bank's shares of stock.

The Bank is currently engaged in accepting deposits from the public and in the extension of the rural credit to small farmers and tenants and to deserving rural industries or enterprises.

As a banking institution, the Bank's operations are regulated and supervised by the Bangko Sentral ng Pilipinas (BSP). As such, the Bank is required to comply with banking rules and regulations such as those relating to maintenance of reserve requirements on deposit liabilities and deposit substitutes and those relating to the adoption and use of safe and sound banking practices, among others, as promulgated by the BSP. The Bank's activities are subject to the provisions of Republic Act (R.A.) No. 8791, *General Banking Law of 2000* and other related banking laws.

The Bank's registered office, which is also its principal place of business, is located at Vamenta Blvd. Corner Lirio Street, Carmen, Cagayan de Oro City.

As of December 31, 2019, the Bank has 66 branches in over eight provinces in Mindanao namely: Lanao del Norte, Misamis Oriental, Misamis Occidental, Zamboanga del Norte, Zamboanga del Sur, Zamboanga Sibugay, Bukidnon and in Davao City; and 12 branches in Visayas namely: Cebu City, Negros Oriental, and Negros Occidental.

### *1.2 Three-Way Merger with D'Asian Hills Bank, Inc. (DAHBI) and Sugbuanon Rural Bank, Inc. (SRBI)*

In 2017, the Bank acquired 20% ownership interest in SRBI, whose business is similar to the Bank's business in accepting deposits from the public and in the extension of rural credit to small farmers and tenants to deserving rural industries or enterprises. Accordingly, the Bank accounted for its investment in SRBI as an associate (see Note 12).

On July 18, 2018, the Bank entered into a Share Purchase Agreement (SPA) for the acquisition and subscription of shares of stock in DAHBI. The acquisition involves 124,526,200 shares representing 100% ownership interest in DAHBI for an aggregate purchase price of P35 million.

The Bank, together with DAHBI and SRBI, the absorbed companies, executed the Plan of Merger on October 28, 2018, which was previously approved by all members of the Bank's Board of Directors (BOD) and by all the stockholders of the Bank on January 13, 2018. The same was filed with BSP and SEC and was subsequently approved on September 5, 2019 and December 27, 2019, respectively.

Upon issuance by the SEC of the Certificate of Filing of the Articles and Plan of Merger, the two banks were merged with the Bank, which is the surviving bank of the merger.

The merger between the three banks was made to enhance the Bank's presence as the merger increased the Bank's branch network from 43 branches in 2018 to 67 branches and 11 branch-lite units (BLU) in 2019. These BLUs will be converted to regular branches as one of merger incentives granted by BSP, including the establishment of additional 16 branches in Visayas and Mindanao.

On the date of acquisition, the equity share in SRBI was remeasured at fair value, as follows (see Notes 12 and 17):

| | |
|---|---|
| Fair value | P 29,984,053 |
| Book value | ( 23,419,842) |
| Gain on fair valuation of previously-held interest | **P 6,564,211** |

The breakdown of the acquisition-date fair value of the assets and liabilities, including the cost of investments follows:

| | Notes | DAHBI | SRBI | **Total** |
|---|---|---|---|---|
| Recognized amounts of identifiable net assets | | | | |
| Cash and cash equivalents | | P 80,660,112 | P 154,019,724 | **P 234,679,836** |
| Investments at amortized cost | 7 | 70,417 | 90,312,937 | **90,383,354** |
| Loans and discounts | 8 | 214,177,358 | 638,638,995 | **852,816,353** |
| Bank premises, furniture, fixtures and equipment | 9 | 54,120,046 | 22,267,779 | **76,387,825** |
| Right-of-use assets | 10 | 15,907,338 | 6,858,956 | **22,766,294** |
| Investment properties | 11 | 62,048,988 | 21,887,830 | **83,936,818** |
| Other resources | 12 | 8,748,031 | 10,034,704 | **18,782,735** |
| Deposit liabilities and other liabilities | 10, 13, 14, 15 | ( 407,808,814) | ( 794,100,662) | **( 1,201,909,476)** |
| | | 27,923,476 | 149,920,263 | **177,843,739** |
| Fair value of the investments for the previously-held interest in SRBI | | - | 29,984,053 | **29,984,053** |
| Fair value of other consideration transferred | | 40,300,000 | 119,936,210 | **160,236,210** |
| | | 40,300,000 | 149,920,263 | **190,220,263** |
| Goodwill | 12 | P 12,376,524 | P - | **P 12,376,524** |

For purposes of determining the goodwill, the Bank determined the fair value of the identified net assets as of December 27, 2019.

The fair value of the loans and receivables acquired as part of the business combination amounted to P840.3 million, with a gross contractual amount of P1.0 billion. As of the acquisition date, the Group best estimate of the contractual cash flow not expected to be collected amounted to P200.8 million (see Note 8).

In determining the fair value of the acquired investment properties, the Bank engaged their internal and independent professional appraisers applying the relevant valuation methodologies. Fair value of previously-held investments were determined using the generally acceptable pricing models.

As consideration for the merger, the Bank paid P40.3 million in 2018 to DAHBI. In 2019, the Bank issued P32.3 million common stock (representing 3,231,711 shares) to SRBI's stockholders, with additional paid-in capital amounting to P87.6 million, as disclosed in Note 16. The fair value of the consideration transferred did not include any contingent consideration as no contingent asset or liability arising from the merger is expected.

The Bank recognized goodwill due to the business synergy achieved through the merger. Aside from the increase in branch networks, the Bank will also have the right to the existing clientele of the absorbed banks.

### *1.3 Approval of Financial Statements*

The financial statements of the Bank as of and for the year ended December 31, 2019 (including the comparative financial statements as of and for the year ended December 31, 2018 and the corresponding figures as of January 1, 2018) were authorized for issue by the BOD on March 18, 2020.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### *2.1 Basis of Preparation of Financial Statements*

*(a) Statement of Compliance with Philippine Financial Reporting Standards*

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board, and approved by the Philippine Board of Accountancy.

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, income and expense. The measurement bases are more fully described in the accounting policies that follow.

*(b) Presentation of Financial Statements*

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements*. The Bank presents all items of income and expenses in a single statement of comprehensive income.

The Bank presents a third statement of financial position as at the beginning of the preceding period when it applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period. The related notes to the third statement of financial position are not required to be disclosed, except for the disclosures required under PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

As a requirement by the BSP under Section 382(c) of the BSP Manual of Regulations for Banks (MORB), all non-financial assets portion of real and other properties acquired (ROPA) shall remain in ROPA. Land and buildings shall be accounted for using the cost model under PAS 40, *Investment Property.* Previously, the Bank uses fair value model to account for its ROPA. Accordingly, the Bank made a retrospective restatement in its financial statements as of and for the year ended December 31, 2018, with comparative figures as of January 1, 2018.

As a result of the change in accounting policy mentioned above, the Bank presents a third statement of financial position as of January 1, 2018 without the related notes, except for the disclosures required under PAS 8.

Presented below are the effects in the financial statements as a result of the change in accounting policy:

| | As Previously Reported | Effects of the Change in Accounting Policy | As Restated |
|---|---|---|---|
| December 31, 2018 | | | |
| *Changes in resources:* | | | |
| Investment properties | P 217,548,139 | (P 78,019,605) | P 139,528,534 |
| Other resources | 383,916,738 | 6,933,221 | 390,849,959 |
| | | (P 71,086,384) | |
| *Changes in component of equity:* | | | |
| Surplus | P 938,501,918 | (P 71,086,384) | P 867,415,534 |
| *Change in profit or loss:* | | | |
| Other income | P 432,672,048 | (P 16,903,515) | P 415,768,533 |
| Other expenses | 643,374,244 | 1,694,844 | 645,069,088 |
| | | (P 18,598,359) | |
| January 1, 2018 | | | |
| *Changes in resources:* | | | |
| Investment properties | P 225,935,434 | (P 115,164,882) | P 110,770,552 |
| Other resources | 173,764,612 | 62,676,857 | 236,441,469 |
| | | (P 52,488,025) | |
| *Changes in component of equity:* | | | |
| Surplus | P 670,105,031 | (P 52,488,025) | P 617,617,006 |

The effects of the change in accounting policy on the Bank's statement of cash flow for the year ended December 31, 2018 are shown below.

| | As Previously Reported | Effects of the Change in Accounting Policy | As Restated |
|---|---|---|---|
| *Changes in operating cash flows:* | | | |
| Net profit before tax | P 367,180,512 | (P 18,598,359) | P 348,582,153 |
| Fair value loss on revaluation of investment properties | 16,903,515 | ( 16,903,515) | - |
| Depreciation and amortization | 37,539,118 | 1,694,844 | 39,233,962 |

(c) *Functional and Presentation Currency*

These financial statements are presented in Philippine pesos, the Bank's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the financial statements of the Bank are measured using its functional currency. Functional currency is the currency of the primary economic environment in which the Bank operates.

## 2.2 *Adoption of New and Amended PFRS*

(a) *Effective in 2019 that are Relevant to the Bank*

The Bank adopted for the first time the following PFRS, amendments, interpretation and annual improvements, which are mandatorily effective for annual periods beginning on or after January 1, 2019:

| | | |
|---|---|---|
| PAS 19 (Amendments) | : | Employee Benefits – Plan Amendment, Curtailment or Settlement |
| PAS 28 (Amendments) | : | Investment in Associates and Joint Ventures – Long-term Interests in Associates and Joint Ventures |
| PFRS 9 (Amendments) | : | Financial Instruments – Prepayment Features with Negative Compensation |
| PFRS 16 | : | Leases |
| International Financial Reporting Interpretations Committee (IFRIC) 23 | : | Uncertainty over Income Tax Treatments |
| Annual Improvements to PFRS (2015-2017 Cycle) | | |
| PAS 12 (Amendments) | : | Income Taxes – Tax Consequences of Dividends |
| PAS 23 (Amendments) | : | Borrowing Costs – Eligibility for Capitalization |
| PFRS 3 and PFRS 11 (Amendments) | : | Business Combinations and Joint Arrangements – Remeasurement of Previously Held Interest in a Joint Operation |

Discussed below and in the succeeding pages are the relevant information about these pronouncements.

(i) PAS 19 (Amendments), *Employee Benefits – Plan Amendment, Curtailment or Settlement.* The amendments clarify that past service cost and gain or loss on settlement is calculated by measuring the net defined benefit liability or asset using updated actuarial assumptions and comparing the benefits offered and plan assets before and after the plan amendment, curtailment or settlement but ignoring the effect of the asset ceiling that may arise when the defined benefit plan is in a surplus position. Further, the amendments now require that if an entity remeasures its net defined benefit liability or asset after a plan amendment, curtailment or settlement, it should also use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after the change to the plan. The application of these amendments had no significant impact on the Bank's financial statements.

(ii) PAS 28 (Amendments), *Investment in Associates and Joint Ventures – Long-term Interest in Associates and Joint Ventures.* The amendments clarify that the scope exclusion in PFRS 9 applies only to ownership interests accounted for using the equity method. Thus, the amendments further clarify that long-term interests in an associate or joint venture – to which the equity method is not applied – must be accounted for under PFRS 9, which shall also include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture. The application of these amendments had no significant impact on the Bank's financial statements.

(iii) PFRS 9 (Amendments), *Financial Instruments – Prepayment Features with Negative Compensation.* The amendments clarify that prepayment features with negative compensation attached to financial assets may still qualify under the "solely payments of principal and interests" (SPPI) test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at fair value through other comprehensive income (FVOCI). The application of these amendments had no significant impact on the Bank's financial statements.

(iv) PFRS 16, *Leases.* The new standard replaced PAS 17, *Leases*, and its related interpretation IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, Standard Interpretations Committee (SIC) 15, *Operating Leases – Incentives* and SIC 27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease.* For lessees, it requires an entity to account for leases "on-balance sheet" by recognizing a "right-of-use" asset and lease liability arising from contract that is, or contains, a lease.

For lessors, the definitions of the type of lease (i.e., finance and operating leases) and the supporting indicators of a finance lease are substantially the same with the provisions under PAS 17. In addition, basic accounting mechanics are also similar but with some different or more explicit guidance related to variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

The Bank has adopted PFRS 16 using the modified retrospective approach as allowed under the transitional provisions of the standard. The adoption of the standard has resulted in adjustments to the amounts recognized in the financial statements as at January 1, 2019, with no cumulative effect recognized in equity Accordingly, comparative information was not restated.

The new accounting policies of the Bank as a lessee are disclosed in Note 2.13(a).

The following table shows the effects of the adoption of PFRS 16 in the carrying amounts and presentation of certain accounts in the statement of financial position as at January 1, 2019.

| | Notes | Carrying Amount (PAS 17) December 31, 2018 | Remeasurement | Carrying Amount (PFRS 16) January 1, 2019 |
|---|---|---|---|---|
| *Assets –* | | | | |
| Right-of-use assets | c, e | P - | P 85,816,114 | P 85,816,114 |
| *Liabilities –* | | | | |
| Lease liabilities | b, e | - | ( 85,816,114 ) | ( 85,816,114 ) |
| Impact on net assets | | P - | P - | P - |

Discussed below are the relevant information arising from the Bank's adoption of PFRS 16 and how the related accounts are measured and presented on the Bank's financial statements as at January 1, 2019.

a. For contracts in place at the date of initial application, the Bank has elected to apply the definition of a lease from PAS 17 and IFRIC 4 and has not applied PFRS 16 to arrangements that were previously not identified as leases under PAS 17 and IFRIC 4.

b. The Bank recognized lease liabilities in relation to leases which had previously been classified as operating leases under PAS 17. These liabilities were measured at the present value of the remaining lease payments, discounted using the Bank's incremental borrowing rate as of January 1, 2019. The Bank's weighted average incremental borrowing rate applied to the lease liabilities on January 1, 2019 ranged from 6.54% to 7.54%.

c. The Bank has elected not to include initial direct costs in the measurement of right-of-use assets at the date of initial application. The Bank also elected to measure the right-of-use assets at its carrying amount as if the new standard had been applied since commencement date, but discounted using the Bank's incremental borrowing rate at the date of application.

d. For leases previously accounted for as operating leases with a remaining lease term of less than 12 months, the Bank has applied the optional exemptions to not recognize right-of-use assets but to account for the lease expense on a straight-line basis over the remaining lease term.

e. The Bank has also used the following practical expedients, apart from those already mentioned above, as permitted by the standard:

   i. application of a single discount rate to a portfolio of leases with reasonably similar characteristics;
   ii. reliance on its historical assessments on whether leases are onerous as an alternative to performing an impairment review on right-of-use assets. As at January 1, 2019, the Bank has no onerous contracts; and,
   iii. use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

A reconciliation of the opening lease liabilities recognized at January 1, 2019 and the total operating lease commitments determined under PAS 17 at December 31, 2018 is shown below.

| | Note | | |
|---|---|---|---|
| Operating lease commitments, December 31, 2018 (PAS 17) | 21.1 | P | 112,406,352 |
| Recognition exemptions – Leases with remaining term of less than 12 months | | ( | 30,000) |
| Operating lease liabilities before discounting | | | 112,376,352 |
| Discount using incremental borrowing rate | | ( | 26,560,238) |
| Lease liabilities, January 1, 2019 (PFRS 16) | | P | 85,816,114 |

(v) IFRIC 23, *Uncertainty over Income Tax Treatments.* This interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Bank to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be on the basis of the accepted tax treatment. Otherwise, the Bank has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above. The application of this interpretation had no significant impact on the Bank's financial statements.

(vi) Annual Improvements to PFRS 2015-2017 Cycle. Among the improvements, the following amendments, which are effective from January 1, 2019, are relevant to the Bank, but had no material impact on the financial statements as these merely clarify existing requirements:

- PAS 12 (Amendments), *Income Taxes – Tax Consequences of Dividends.* The amendments clarify that an entity should recognize the income tax consequence of dividend payments in profit or loss, other comprehensive income or equity according to where the entity originally recognized the transactions that generated the distributable profits.

- PAS 23 (Amendments), *Borrowing Costs – Eligibility for Capitalization.* The amendments clarify that if any specific borrowing remains outstanding after the related qualifying asset is ready for its intended use or sale, such borrowing is treated as part of the entity's general borrowings when calculating the capitalization rate.

- PFRS 3, *Business Combinations* and PFRS 11, *Joint Arrangements – Remeasurement of Previously Held Interests in a Joint Operation.* The amendments to PFRS 3 clarify that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business. The amendments to PFRS 11 clarify that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business.

*(b) Effective Subsequent to 2019 but not Adopted Early*

There are amendments to existing standards effective for annual periods subsequent to 2019, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions; and, unless otherwise stated, none of these are expected to have significant impact on the Bank's financial statements:

(i) PAS 1 (Amendments), *Presentation of Financial Statements* and PAS 8 (Amendments), *Accounting Policies, Changes in Accounting Estimates and Errors – Definition of Material* (effective from January 1, 2020). The amendments provide a clearer definition of 'material' in PAS 1 by including the concept of 'obscuring' material information with immaterial information as part of the new definition, and clarifying the assessment threshold (i.e., misstatement of information is material if it could reasonably be expected to influence decisions made by primary users, which consider the characteristic of those users as well as the entity's own circumstances). The definition of material in PAS 8 has been accordingly replaced by reference to the new definition in PAS 1. In addition, amendment has also been made in other standards that contain definition of material or refer to the term 'material' to ensure consistency.

(ii) Revised Conceptual Framework for Financial Reporting (effective from January 1, 2020). The revised conceptual framework will be used in standard-setting decisions with immediate effect. Key changes include (a) increasing the prominence of stewardship in the objective of financial reporting, (b) reinstating prudence as a component of neutrality, (c) defining a reporting entity, which may be a legal entity, or a portion of an entity, (d) revising the definitions of an asset and a liability, (e) removing the probability threshold for recognition and adding guidance on derecognition, (f) adding guidance on different measurement basis, and, (g) stating that profit or loss is the primary performance indicator and that, in principle, income and expenses in other comprehensive income should be recycled where this enhances the relevance or faithful representation of the financial statements.

No changes will be made to any of the current accounting standards. However, entities that rely on the framework in determining their accounting policies for transactions, events or conditions that are not otherwise dealt with under the accounting standards will need to apply the revised framework from January 1, 2020. These entities will need to consider whether their accounting policies are still appropriate under the revised framework.

### 2.3 *Financial Assets*

Financial assets are recognized when the Bank becomes a party to the contractual terms of the financial instrument. For purposes of classifying financial assets, an instrument is considered as an equity instrument if it is non-derivative and meets the definition of equity for the issuer in accordance with the criteria of PAS 32, *Financial Instruments: Presentation.* All other non-derivative financial instruments are treated as debt instruments.

(a) *Classification, Measurement and Reclassification of Financial Assets*

The classification and measurement of financial assets is driven by the Bank's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

Financial assets are measured at amortized cost if both of the following conditions are met:

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

Financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method, less any allowance.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of the financial assets except for those that are subsequently identified as credit-impaired. For credit-impaired financial assets, the effective interest rate is applied to the net carrying amount of the financial assets (after deduction of the loss allowance). The interest earned is recognized as Interest income in the statement of comprehensive income.

The Bank's financial assets at amortized cost are presented in the statement of financial position as Cash and Other Cash Items, Due from BSP, Due from Other Banks, Loans and Discounts, and Investment Securities at Amortized Cost accounts, Sales contract receivables, Accounts receivable, Advances to an associate, and Other investment accounts under Other Resources account.

The Bank may irrevocably elect at initial recognition to classify a financial asset that meets the amortized cost criteria above as at fair value through profit or loss (FVTPL) if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortized cost. In 2019 and 2018, the Bank has not made such designation.

(b) *Impairment of Financial Assets*

The Bank recognizes allowances for ECL on a forward-looking basis associated with its financial assets at amortized cost. No impairment loss is recognized on equity investments that are either measured at FVTPL or designated at FVOCI.

The measurement of the ECL reflects: (i) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; (ii) the time value of money; and, (iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The amount of allowance for ECL is updated at the end of each reporting period to reflect the changes in credit risk of the financial asset since initial recognition. The Bank recognizes lifetime ECL when there has been a significant increase in credit risk (SICR) since initial recognition. However, if the credit risk on the financial instrument has not increased significantly since initial recognition, the Bank measures the loss allowance for that financial instrument at an amount equal to 12-month ECL. Lifetime ECL represents the expected credit losses that will result from all possible default events over the expected life of a financial instrument. In contrast, 12-month ECL represents the portion of lifetime ECL that is expected to result from default events on a financial instrument that are possible within 12 months after the end of the reporting period.

The Bank's ECL model follows a three-stage impairment approach, which guide in the determination of the loss allowance to be recognized in the financial statements. The staging of financial assets, definition of default for purposes of determining ECL, and credit risk assessment are further discussed in Note 4.1.

ECL is a function of the probability of default (PD), loss-given default (LGD), and exposure-at-default (EAD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgement. These elements are discussed more fully in Note 4.1.

The Bank calculates ECL either on an individual or a collective basis. For modelling ECL parameters which were carried out on a collective basis, the financial instruments are grouped on the basis of shared credit risk characteristics, such as but not limited to instrument type, credit risk rating, collateral type, product type, historical net charge-offs, industry type, and geographical locations of the borrowers or counterparties.

The Bank recognizes an impairment loss in profit or loss for all financial instruments subjected to ECL impairment assessment with a corresponding adjustment to their carrying amount through a loss allowance account. With respect to investments in debt securities that are measured at FVOCI, if any, the related loss allowance account is recognized in other comprehensive income and accumulated in the Revaluation Reserve account, and does not reduce the carrying amount of the financial asset in the statement of financial position.

*(c) Derecognition of Financial Assets*

*(i) Modification of Loans*

When the Bank derecognizes a financial asset through renegotiation or modification of contractual cash flows of loans to customers, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank considers, among others:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay;
- Whether any substantial new terms are introduced that will affect the risk profile of the loan;
- Significant extension of the loan term when the borrower is not in financial difficulty;
- Significant change in the interest rate;
- Change in the currency the loan is denominated in; and/or,
- Insertion of collateral, other security or credit enhancements that will significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Bank derecognizes the financial asset and recognizes a "new" asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are as gain or loss on derecognition of financial assets in profit or loss. As to the impact on ECL measurement, the expected fair value of the "new" asset is treated as the final cash flow from the existing financial asset at the date of derecognition; such amount is included in the calculation of cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows of the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). As to the impact on ECL measurement, the derecognition of the existing financial asset will result in the expected cash flows arising from the modified financial asset to be included in the calculation of cash shortfalls from the existing financial asset.

*(ii) Derecognition Other than Modification of Loans*

A financial asset (or where applicable, a part of a financial asset or part of a group of financial assets) is derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

### *2.4 Bank Premises, Furniture, Fixtures and Equipment*

Land is stated at cost less accumulated impairment losses, if any. All other items of bank premises, furniture, fixtures and equipment are stated at cost less accumulated depreciation, amortization and any impairment in value.

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

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

| | |
|---|---|
| Building | 20 years |
| Furniture, fixtures and equipment | 3-5 years |
| Transportation equipment | 5 years |

Leasehold improvements are amortized over the term of the lease or useful lives of the improvements of ten years, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.15).

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

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

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

## *2.5 Investment Properties*

Investment properties represent land and buildings acquired by the Bank in settlement of loans from defaulting borrowers through foreclosure or dacion in payment. These properties are neither held by the Bank for sale in the next 12 months nor used in the rendering of services or for administrative purposes.

Investment properties are stated at cost, less accumulated depreciation and any impairment losses (see Note 2.15). The cost of an investment property comprises its purchases price and directly attributable costs incurred such as legal fees, transfer taxes and other transaction costs.

Depreciation and impairment loss are recognized in the same manner as in bank premises, furniture, fixtures and equipment.

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

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

## *2.6 Other Resources*

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

Other resources include the Bank's investment in an associate. An associate is an entity over which the Bank is able to exert significant influence but which are neither subsidiaries nor interests in joint venture. The investment in an associate is initially recognized at cost and subsequently accounted for in the financial statements using the equity method from the date on which the investee becomes an associate. On acquisition of the investment in an associate, any excess of the cost of the investment over the Bank's share in the fair value of the net assets of the investee is recognized as goodwill, included as part of the investment cost. Any excess of the share in the fair value of the net assets of the investee over the cost is recognized in profit or loss as part of Gain on fair valuation of previously held interest under Other Income account in the statement of comprehensive income.

Under the equity method, the investment cost is adjusted for the Bank's share in net profit or loss of the associate. Dividend distributions from the associate are accounted for as a reduction of the carrying value of the investment. Furthermore, the Bank's share in the components of other comprehensive income is recognized as part of investment cost. When the Bank's share in net losses of an associate exceeds the Bank's cost, the Bank discontinues recognizing its share of losses, to the extent that it has no legal or constructive obligation on behalf of the associate.

When the Bank reduces its ownership interests in an associate but continues to use the equity method, the Bank reclassifies to profit or loss its share of the gain or loss that had previously been recognized in other comprehensive income relating to the reduction in ownership interest, if, and only if, that gain or loss is allowed to be recycled in accordance with existing standards.

Amounts reported in the financial statements of the associate have been adjusted where necessary to ensure consistency with the accounting policies of the Bank.

At the end of the reporting period, the Bank makes an assessment whether there is any indication of impairment in its investment in an associate. If any indication exists, the recoverable amount is estimated and any impairment loss is recognized in the statement of income (see Note 2.15).

Other resources also include goodwill from business combination. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given up to acquire an asset at the time of its acquisition.

Business acquisitions are accounted for using the acquisition method of accounting.

Goodwill represents the excess of the cost of an acquisition over fair value of the Bank's share of the net identifiable assets of the acquired business at the date of acquisition. Subsequent to initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is to be tested annually for impairment and carried at cost less accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The cash-generating units or groups of cash-generating units are identified according to operating segment.

Gains and losses on the disposal of an interest in a subsidiary include the carrying amount of goodwill relating to it.

If the business combination is achieved in stages, the acquirer is required to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in the profit or loss or other comprehensive income, as appropriate.

Any contingent consideration to be transferred by the Bank is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

### *2.7 Assets Classified as Held for Sale*

Assets classified as held for sale include repossessed jewelry and motor vehicle that the Bank intends to sell within one year from the date of classification as held for sale and are included as part of Other Resources in the statements of financial position.

The Bank classifies an asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. In the event that the sale of the asset is extended beyond one year, the extension of the period required to complete the sale does not preclude an asset from being classified as held for sale if the delay is caused by events or circumstances beyond the Bank's control and there is sufficient evidence that the Bank remains committed to its plan to sell the asset.

Assets held for sale are measured at the lower of their carrying amounts, immediately prior to their classification as held for sale, and their fair value less costs to sell. The Bank shall recognize an impairment loss for any initial or subsequent write-down of the asset at fair value less cost to sell. Gain for any subsequent increase in fair value less cost to sell of an asset is recognized to the extent of the cumulative impairment loss previously recognized. Assets classified as held for sale are not subject to depreciation.

If the Bank has classified an asset as held for sale, but the criteria for it to be recognized as held for sale are no longer satisfied, the Bank shall cease to classify the asset as held for sale.

The gain or loss arising from the sale or remeasurement of held for sale assets is recognized in profit or loss and included as part of Other Income in the statement of comprehensive income.

### *2.8 Financial Liabilities*

Financial liabilities, which include deposit liabilities, bills payable, and accrued expenses and other liabilities (except for post-employment benefit obligation and tax-related liabilities) are recognized when the Bank becomes a party to the contractual terms of the instrument. All interest-related charges are recognized as an expense under the caption Interest Expense in the statement of comprehensive income.

Deposit liabilities are recorded initially at fair value and subsequently measured at amortized cost.

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

Accrued expenses and other liabilities are recognized initially at their fair values and subsequently measured at amortized cost using effective interest method for maturities beyond one year, less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities upon declaration by the Bank.

Financial liabilities are derecognized from the statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between the carrying amount of the financial liability derecognized and the consideration paid or payable is recognized in profit or loss.

### *2.9 Offsetting of Financial Instruments*

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

### *2.10 Provisions and Contingencies*

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive obligation that has resulted from past events.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases, where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements. Similarly, possible inflows of economic benefits to the Bank that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements. On the other hand, any reimbursement that the Bank can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

### *2.11 Capital Funds*

Capital stock represents the nominal value of shares that have been issued.

Other reserves include any premium received on the initial issuance of capital stock representing the difference between the net assets received and the amount of the shares issued arising from a business combination. Any transaction costs associated with the issuance of shares are deducted from the other reserves, net of any related income tax benefits.

Remeasurements of defined benefit plan comprise of net accumulated actuarial gains or losses arising from experience adjustments and other changes in actuarial assumptions, and actual return on plan assets (excluding amounts pertaining to net interest). It also includes the share in associate's other comprehensive income, which was subsequently reclassified due to the merger.

Surplus includes all current and prior period results of operations as reported in the profit or loss section of the statement of comprehensive income, reduced by the amount of any dividends declared.

## *2.12 Other Income and Expenses*

Revenue is recognized only when (or as) the Bank satisfies a performance obligation by transferring control of the promised services to the customer. A contract with a customer that results in a recognized financial instrument in the Bank's financial statements may partially be within the scope of PFRS 9 and partially within the scope of PFRS 15, *Revenues*. In such case, the Bank first applies PFRS 9 to separate and measure the part of the contract that is in-scope of PFRS 9, and then applies PFRS 15 to the residual part of the contract.

Expenses and costs, if any, are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. All finance costs are reported in profit or loss on accrual basis, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset, if any (see Note 2.17).

The Bank also earns service fees and commissions on various banking services, and gains on sale of properties, which are supported by contracts approved by the parties involved. These revenues are accounted for by the Bank in accordance with PFRS 15. For revenues arising from various banking services, which are to be accounted for under PFRS 15, the following provides information about the nature and timing of satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies:

*(a)* *Service fees and charges* – Service charges, fees and commissions are generally recognized over the term of the loan. These include the following accounts:

*(i)* *Commission and fees* – these income arising from loans, deposits, and other banking transactions are recognized as income based on agreed terms and conditions with customers, which are generally when the services have been performed.

*(ii)* *Late payment fees* – these are billed on late payments of loans and are recognized as income upon occurrence of the late payment event.

*(b)* *Penalties* – these are charges from deposit accounts that fall under dormancy or maintaining balance. These fees are recognized at the time of dormancy.

*(c)* *Gains on Assets Sold*

Gains on assets sold under Other Income account, arise from the disposals of bank premises, furniture, fixtures and equipment, investment properties and other non-financial assets. The Bank recognizes the gain on sale at the time the control of the assets is transferred to the buyer, when the Bank does not retain either continuing managerial involvement to the degree usually associated with ownership, or effective control over the assets sold, and when the collectability of the entire sales price is reasonably assured. Gains on sale and redemption of assets is presented under Other Operating Income account in the statement of comprehensive income.

### *2.13 Leases*

*(a) Accounting for Leases in Accordance with PFRS 16 (2019)*

For any new contracts entered into on or after January 1, 2019, the Bank considers whether a contract is, or contains, a lease. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. To apply this definition, the Bank assesses whether the contract meets three key evaluations which are whether:

- the contract contains an identified asset, which is either explicitly identified in the contract or implicitly specified by being identified at the time the asset is made available to the Bank;

- the Bank has the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use, considering its rights within the defined scope of the contract; and,

- the Bank has the right to direct the use of the identified asset throughout the period of use. The Bank assesses whether it has the right to direct 'how and for what purpose' the asset is used throughout the period of use.

The right-of-use asset is measured at cost, which is made up of the initial measurement of the lease liability, and any lease payments made in advance of the lease commencement date (net of any incentives received). Subsequently, the Bank depreciates the right-of-use asset on a straight-line basis from the lease commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The Bank also assesses the right-of-use asset for impairment when such indicators exist (see Note 2.15).

On the other hand, the Bank measures the lease liability at the present value of the lease payments unpaid at the commencement date, discounted using the interest rate implicit in the lease if that rate is readily available or the Bank's incremental borrowing rate. Lease payments include fixed payments (including in-substance fixed) and payments arising from options (either renewal or termination) reasonably certain to be exercised. Subsequent to initial measurement, the liability will be reduced for payments made and increased for interest. It is remeasured to reflect any reassessment or modification, or if there are changes in in-substance fixed payments. When the lease liability is remeasured, the corresponding adjustment is reflected in the right-of-use asset, or to profit and loss if the right-of-use asset is already reduced to zero.

The Bank has elected to account for short-term leases using the practical expedients. Instead of recognizing a right-of-use asset and lease liability, the payments in relation to these are recognized as an expense in profit or loss on a straight-line basis over the lease term.

On the statement of financial position, right-of-use assets and lease liabilities have been presented separately from bank premises, furniture, fixtures and equipment and other liabilities, respectively.

*(b) Accounting for Leases in Accordance with PAS 17 (2018)*

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

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

A reassessment is made after inception of the lease only if one of the following applies:

*(a)* there is a change in contractual terms, other than a renewal or extension of the arrangement;

*(b)* a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;

*(c)* there is a change in the determination of whether fulfillment is dependent on a specified asset; or,

*(d)* there is a substantial change to the asset.

### *2.14 Foreign Currency Transactions and Translation*

The accounting records of the Bank are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates. Resources and liabilities denominated in foreign currencies are translated to Philippine pesos at the prevailing exchange rates at the end of the reporting period.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

### *2.15 Impairment of Non-financial Assets*

Bank premises, furniture, fixtures and equipment, right-of-use assets, intangible assets, and other non-financial assets are subject to impairment testing whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Intangible assets with an indefinite useful life, such as goodwill, are tested for impairment at least annually.

For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, some assets are tested for impairment either individually or at the cash-generating unit level.

Impairment loss is recognized in profit or loss for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount which is the higher of its fair value less costs to sell and its value in use. In determining value in use, management estimates the expected future cash flows from each cash-generating unit and determines the suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Bank's latest approved budget, adjusted as necessary to exclude the effects of asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. Except for goodwill, an impairment loss is reversed if the asset's or cash generating unit's carrying amount recoverable amount exceeds its carrying amount.

### *2.16 Employee Benefits*

The Bank provides post-employment benefits to employees through a defined benefit plan, as well as a defined contribution plan and other employee benefits, which are recognized and measured as follows:

*(a) Post-Employment Defined Benefit Plan*

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

The liability presented as part of Accrued Expenses and Other Liabilities account in the statement of financial position for a defined benefit plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows for expected benefit payments using a discount rate derived from the interest rates of a zero coupon government bonds [using the reference rates published by Bloomberg using its valuation technology, Bloomberg Valuation (BVAL)], that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability. BVAL provides evaluated prices that are based on market observations from contributed sources.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in net interest) are reflected immediately in the statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Net interest is calculated by applying the discount rate at the beginning of the period, unless there is a plan amendment, curtailment or settlement during the reporting period. The calculation also takes into account any changes in the net defined benefit liability or asset during the period as a result of contributions to the plan or benefit payments. Net interest is reported as part of Interest Expense or Interest Income account in the statement of comprehensive income.

Past service costs are recognized immediately in profit or loss in the period of a plan amendment or curtailment.

*(b)* *Post-Employment Defined Contribution Plan*

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

*(c)* *Termination Benefits*

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits at the earlier of when it can no longer withdraw the offer of such benefits and when it recognizes costs for a restructuring that is within the scope of PAS 37, and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the reporting period are discounted to their present value.

*(d)* *Compensated Absences and Other Employee Benefits*

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. In addition, the Bank recognizes a liability and an expense for other employee benefits based on a formula that is fixed, regardless of the Bank's income after certain adjustments, and does not take into consideration the profit attributable to the Bank's shareholders.

The Bank recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation. They are presented as Post-employment benefit obligation under the Accrued Expenses and Other Liabilities account in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement.

### *2.17 Borrowing Costs*

Borrowing costs are recognized as expenses in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are complete.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

### *2.18 Income Taxes*

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

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

Deferred tax is provided using the liability method on temporary differences at the end of the reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carry forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax asset can be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

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

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. For purposes of measuring deferred tax assets and deferred tax liabilities for investment properties that are measured using the fair value model, the carrying amounts of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted, that is, when the investment property is depreciable and is held within the business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

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

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

### *2.19 Related Party Transactions and Relationships*

Related party transactions are transfers of resources, services or obligations between the Bank and its related parties, regardless whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. These parties include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Bank; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank and close members of the family of any such individual; and, (d) the Bank's funded retirement plan.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

### *2.20 Events After the End of the Reporting Period*

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

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

### *3.1 Critical Management Judgments in Applying Accounting Policies*

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

*(a) Determination of Lease Term of Contracts with Renewal and Termination Options (2019)*

In determining the lease term, management considers all relevant factors and circumstances that create an economic incentive to exercise a renewal option or not exercise a termination option. Renewal options and/or periods after termination options are only included in the lease term if the lease is reasonably certain to be extended or not terminated.

The factors that are normally the most relevant are (a) if there are significant penalties should the Bank pre-terminate the contract, (b) if any leasehold improvements are expected to have a significant remaining value, (c) historical lease durations, and (d) costs and business disruption required to replace the leased asset, the Bank is reasonably certain to extend and not to terminate the lease contract.

The Bank did not include renewal options as part of the lease term as the terms are renewable upon mutual agreement.

The lease term is reassessed if an option is actually exercised or not exercised or the Bank becomes obliged to exercise or not exercise it. The assessment of reasonable certainty is only revised if a significant event or a significant change in circumstances occurs, which affects this assessment, and that is within the control of the Bank.

*(b) Evaluation of Business Model Applied in Classifying Financial Instruments*

The Bank manages its financial assets based on business models that maintain adequate level of financial assets to match its expected cash outflows, largely its core deposit funding arising from customers' withdrawals and continuing loan disbursements to borrowers, while maintaining a strategic portfolio of financial assets for trading activities consistent with its risk appetite.

The Bank's business models reflect how it manages its portfolio of financial instruments. The Bank's business models need not be assessed at entity level or as a whole but shall be applied at the level of a portfolio of financial instruments (i.e., group of financial instruments that are managed together by the Bank) and not on an instrument-by-instrument basis (i.e., not based on intention or specific characteristics of individual financial instrument), except for designation of equity instruments at FVOCI.

In determining the classification of a financial instrument, the Bank evaluates in which business model a financial instrument or a portfolio of financial instruments belong to taking into consideration the objectives of each business model established by the Bank (e.g., held-for-trading, generating accrual income, direct matching to a specific liability) as those related to the Bank's investment, trading and lending strategies.

In addition, PFRS 9 emphasizes that if more than an infrequent sale is made out of a portfolio of financial assets carried at amortized cost, an entity should assess whether and how such sales are consistent with the objective of collecting contractual cash flows. In making this judgment, the Bank considers certain circumstances documented in its business model manual to assess that an increase in the frequency or value of sales of financial instruments in a particular period is not necessary inconsistent with a held-to-collect business model if the Bank can explain the reasons for those sales and why those sales do not reflect a change in the Bank's objective for the business model.

*(c)* *Testing the Cash Flow Characteristics of Financial Assets*

In determining the classification of financial assets, the Bank assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal outstanding, with interest representing time value of money and credit risk associated with the principal amount outstanding. The assessment as to whether the cash flows meet the SPPI test is made in the currency in which the financial asset is denominated. Any other contractual term that changes the timing or amount of cash flows (unless it is a variable interest rate that represents time value of money and credit risk) does not meet the amortized cost criteria. In cases where the relationship between the passage of time and the interest rate of the financial instrument may be imperfect, known as modified time value of money, the Bank assesses the modified time value of money feature to determine whether the financial instrument still meets the SPPI criterion. The objective of the assessment is to determine how different the undiscounted contractual cash flows could be from the undiscounted cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). If the resulting difference is significant, the SPPI criterion is not met. In view of this, the Bank considers the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument.

*(d)* *Distinction Between Investment Properties and Owner-occupied Properties*

The Bank determines whether a property qualifies as an investment property, assets held-for-sale or owner-occupied properties. In making its judgment, the Bank considers whether the property generates cash flows largely independent of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to the property but also to other assets used in its banking operations.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use for administrative purposes. If these portions can be sold separately (or leased out separately under finance lease), the Bank accounts for the portions separately. If the portions cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in its banking operations or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property.

The Bank considers each property separately in making its judgment.

*(e) Distinction Between Operating and Finance Leases (2018)*

The Bank has entered into various lease agreements as a lessee. Judgment was exercised by management to distinguish each lease agreement as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgment will result in either overstatement or understatement of assets and liabilities. Management has assessed that all its existing lease arrangements qualify under operating lease.

*(f) Recognition of Provisions and Contingencies*

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition of provisions and contingencies are discussed in Note 2.10 and relevant disclosures are presented in Note 21.

In dealing with the Bank's various legal proceedings, its estimate of the probable costs that may arise from claims and contingencies has been developed in consultation and coordination with the Bank's internal and outside counsels acting in defense for the Bank's legal cases and are based upon the analysis of probable results.

Although the Bank does not believe that its on-going proceedings will have material adverse effect on the Bank's financial position, it is possible that future results of operations could be materially affected by changes in the estimates or in the effectiveness of the strategies conducted relating to those proceedings.

*(g) Distinction Between Asset Acquisition and Business Combinations*

The Bank distinguishes a business combination from an asset acquisition by assessing if an acquisition constitutes that of a business. The Bank defines 'business' as what it is defined in existing standards. A business is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants. A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

### *3.2 Key Sources of Estimation of Uncertainty*

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of each reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of resources and liabilities within the next reporting period:

*(a) Determination of Appropriate Discount Rate in Measuring Lease Liabilities (2019)*

The Bank measures its lease liabilities at present value of the lease payments that are not paid at the commencement date of the lease contract. The lease payments were discounted using a reasonable rate deemed by management equal to the Bank's incremental borrowing rate. In determining a reasonable discount rate, management considers the term of the leases, the underlying asset and the economic environment. Actual results, however, may vary due to changes in estimates brought about by changes in such factors.

*(b) Estimation of Allowance for ECL on Financial Assets*

When measuring allowance for ECL for relevant categories of financial assets, management applies judgment in defining the criteria in assessing whether a financial asset has experienced SICR since initial recognition, and in the estimation of the contractual cash flows due from counterparty and those that the Bank would expect to receive, taking into account the cash flows from the realization of collateral and integral credit enhancements. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions about future economic conditions and credit behaviour of counterparties (e.g., the likelihood of counterparties defaulting and the resulting losses). The computation of the ECL also consider the use of reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other that may result in different levels of loss allowance.

Significant factors affecting the estimates on the ECL model include:

- criteria for assessing if there has been an SICR and when a financial asset will be transferred between the three stages;
- the Bank's definition of default for different segments of credit exposures that considers the regulatory requirements;
- establishment of LGD parameters based on historical recovery rates of claims against defaulted counterparties across different group of financial instruments; and,

Explanation of the inputs, assumptions and estimation used in measuring ECL, and the analysis of the allowance for ECL on various groups of financial instruments is further detailed in Note 4.1.

*(c) Estimation of Useful Lives of Bank Premises, Furniture, Fixtures and Equipment, Right-of-Use Assets, Investment Properties and Intangible Assets*

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment, right-of-use assets, investment properties and intangible assets such as software based on the period over which the assets are expected to be available for use. The estimated useful lives of these assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

The carrying amount of bank premises, furniture, fixtures and equipment, right-of-use assets, investment properties and intangible assets (presented under Other Resources) are disclosed in Notes 9, 10, 11 and 12.3, respectively. Based on management's assessment as at December 31, 2019 and 2018, there is no change in the estimated useful lives of these assets during those years. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(d) *Estimation of Fair Value Disclosures for Assets Held for Sale and Investment Properties*

The Bank's assets held for sale is carried and measured at lower of carrying amount or fair value less cost to sell. The estimated fair values of assets held for sale as disclosed in Note 5.3, are determined on the basis of the appraisals conducted by qualified internal and independent professional appraisers applying the relevant valuation methodologies as discussed therein.

In determining the fair value less cost to sell of assets held for sale, management takes into account the most reliable evidence available at the time the estimates are made. These estimates include prices at which the repossessed assets are expected to be sold and the necessary cost to be incurred in disposing the assets. The price and cost estimates, however, could change in the future. The above factor is considered key source of estimation uncertainty and may cause significant adjustments to the Bank's assets held for sale within the next reporting period. The methodology and assumptions used in estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

For assets held for sale with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties. As of December 31, 2019 and 2018, there were no circumstances that management has determined possible adjustments in the fair value of the assets held for sale.

(e) *Fair Value Measurement for Financial Instruments*

Management applies valuation techniques to determine the fair value of financial instruments where active market quotes are not available. Valuation techniques are used to determine fair values which are validated and periodically reviewed. To the extent practicable, models use observable data, however, areas such as counterparty credit risk, volatilities and correlations require management to make estimates. Changes in assumptions could affect the reported fair value of financial instruments. The Bank use judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

(f) *Estimation of Impairment Losses of Non-financial Assets*

In assessing impairment, management estimates the recoverable amount of each asset or a cash-generating unit based on expected future cash flows and uses an interest rate to calculate the present value of those cash flows. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate (see Note 2.15). Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

(g) *Determination of Realizable Amount of Deferred Tax Assets*

The Bank reviews its deferred tax assets at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Management assessed that the carrying amount of deferred tax assets recognized in the statements of financial position as disclosed in Note 19 can be utilized in the coming years.

(h) *Valuation of Post-employment Defined Benefit*

The determination of the Bank's obligation and cost of post-employment defined benefit is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, discount rates and salary rate increase. A significant change in any of these actuarial assumptions may generally affect the recognized expense, other comprehensive income or losses and the carrying amount of the post-employment benefit obligation in the next reporting period.

The amounts of post-employment benefit obligation and expense and an analysis of the movements in the estimated present value of post-employment benefit, as well as the significant assumptions used in estimating such obligation are presented in Note 18.

## 4. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Bank is exposed to a variety of financial risks in relation to its financial instruments. The Bank's financial assets and financial liabilities by category are summarized in Note 5. The main types of risks are credit risk, liquidity risk, market risk (foreign currency and interest rate risks), and operational risk and anti-money laundering controls.

The Bank's risk management, which is closely coordinated with the BOD, Management Committee and the Risk Management Committee (RMC) of the Bank, focuses on actively securing the Bank's short to medium-term cash flows by minimizing the exposure to financial markets. Long-term financial investments are managed to generate reasonable returns.

The Bank does not actively engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Bank is exposed to are described as follows:

### *4.1 Credit Risk*

Credit risk is the risk that a customer or counterparty may fail to fulfill its contractual obligations to the Bank. This includes risk of non-payment by borrowers and issuers, failed settlement of transactions and default on outstanding contracts.

The Bank manages credit risk through a system of policies and authorities that govern the processes and practices of all credit-originating and borrowing relationship management units.

The following tools, among others, are used by the Bank in identifying, assessing and managing credit risk:

- Established credit policies, asset allocations and concentration limits, collateral acceptance criteria, target market and clearly defined approving authorities;
- Independence of credit control and monitoring functions from the credit risk-taking function;
- Periodic monitoring of individual account performance;
- Active loan portfolio management to determine the quality of the loan portfolio, including risks associated with particular industry sectors, loan size and maturity, monitoring portfolio growth, collection performance and delinquency trends, trend of non-performing loans, concentration risk, and other performance indicators; and,
- Close monitoring of remedial accounts.

The Finance Committee, Credit Risk Committee and Risk Oversight Committee undertake portfolio management by reviewing the Bank's loan portfolio, including the portfolio risks associated with particular industry sectors, loan size and maturity, and development of a strategy for the Bank to achieve its desired portfolio mix and risk profile. They also review the Bank's loan portfolio in line with the Bank's policy of not having significant unwarranted concentrations of exposure to individual counterparties, in accordance with the BSP's prohibitions on maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its net worth.

For investment securities at amortized cost, credit risk is addressed by setting limits as to the maximum amount of investment that can be made on certain type of security with consideration of the credit quality of the counterparty.

#### *4.1.1 Credit Risk Assessment*

The Bank's credit risk measurement is performed on different segments of financial asset portfolio such as: (a) consumer, which include agricultural loans, agrarian loans, microfinance, small and medium entity (SME) loans, and other loans such as barangay and teacher's loans; and (b) investment in debt securities that are measured at amortized cost.

Loans and receivables, regardless if the accounts have been fully paid, extended or renewed in subsequent year or period, are subjected to evaluation for possible losses. The Bank's estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows, and the passage of time. The assessment of credit risk of a portfolio of assets requires further estimations as to the PDs occurring, of the associated loss ratios, and of default correlations between counterparties; accordingly, such the credit risk is measured using PD, EAD, and LGD, for purposes of measuring ECL.

For the Bank's debt securities, credit ratings published by reputable external rating agency (such as Standard & Poor's) are used. These ratings are continuously monitored and updated. The PD associated with each rating is determined based on realized default rates over the previous 12 months, as published by the rating agency.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits when appropriate. Exposure to credit risk is also managed in part by obtaining collateral or corporate and personal guarantees.

### *4.1.2 Expected Credit Loss Measurement Inputs*

Integral in the Bank's established policies in measuring and calculating ECL on financial instrument is the use of appropriate model for each segment of financial asset that applies relevant inputs and assumptions, including forward-looking information as appropriate.

*(a)* *Significant Increase in Credit Risk*

The Bank assesses whether the credit risk on a financial instrument has increased significantly since initial recognition, through assessments of the change in risks of default occurring over the remaining life of the financial instrument. In making this assessment, the Bank assesses on a periodic basis both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information, as appropriate. These may include macroeconomic conditions, economic sector and geographical region relevant to the counterparty or borrower, and other factors that are counterparty-specific. Certain qualitative criteria are also being considered by the Bank in assessing SICR. These are but not limited to: actual or expected short-term delays in payments which is normally not later than 30 days, extension to the terms granted, previous arrears within the last 12 months and significant adverse changes in business, financial and/or economic conditions in which the borrowers operate (e.g., calamities requiring BSP relief program). As the Bank holds various arrays of financial instruments, the extent of assessment may depend on the materiality of the financial instrument or the complexity of the portfolio being assessed.

A '3-stage' impairment model has been adopted by the Bank based on changes in credit quality since initial recognition of the financial asset [see Note 2.3(b)]:

*(i)* Stage 1 – comprised of all credit exposures that are considered 'performing' and with no observed SICR since initial recognition and includes financial assets that are identified to have low credit risk'. For these instruments, the loss allowance is determined based on a 12-month ECL.

*(ii)* Stage 2 – comprises of all financial instruments assessed to have SICR subsequent to the initial recognition of the financial assets, though not yet deemed credit-impaired. This also includes those loan accounts and facilities where the credit risk has improved and have been reclassified from 'Stage 3' lifetime ECL is recognized for these financial instruments.

*(iii)* Stage 3 – comprises credit exposures which are assessed as 'credit-impaired', thus considered by the Bank as 'non-performing', which is assessed consistently with the Bank's definition of default for each loan portfolio. A lifetime ECL is recognized for all credit-impaired financial assets.

The Bank also considers the quantitative criteria based on the BSP Manual of Regulations for Banks (MORB) Section 143 (Appendix 15), as amended by BSP Circular 1011, *Guidelines on the Adoption of PFRS 9*, in classifying the status of loan.

*(b)* *Definition of Default*

*(i) Loans and Receivables*

The Bank defines a financial asset as in default, which is aligned with the definition of credit-impaired asset, when it meets one or more of the following criteria:

- *Quantitative* – in this criterion, the borrower is more than 30 days past due on its contractual payments.

- *Qualitative* – this includes instances where the borrower is unlikely to pay its obligations and is deemed to be in significant financial difficulty, which include cases of long-term forbearance, borrower's death, insolvency, breach of financial covenant/s, disappearance of active market for that financial instrument because of financial difficulties, and bankruptcy.

These criteria have been applied to all financial instruments held by the Bank and are consistent with the definition of default used for internal credit risk management purposes. Such definition has been consistently applied in determining PD, EAD, and LGD throughout the ECL calculations of the Bank.

*(ii) Investment in Debt Securities*

Investments in debt securities are assessed as credit-impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of an event that occurred after the initial recognition of the security (a "loss event") and that loss event has impact on the estimated future cash flows of the securities. Losses expected as a result of future event, shall also be considered in estimating the ECL. In making assessment of whether an investment in debt is credit-impaired, the Bank considers the following factors:

- the market's assessment of creditworthiness as reflected in the bond yields;
- the rating agencies' assessment of creditworthiness; or,
- the probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness

*(c) Key Inputs, Assumptions and Estimation Techniques Used in the Measurement of ECL*

The key elements used in the calculation of ECL are as follows:

*(i)* PD represents an estimate of likelihood of a borrower defaulting on its financial obligation over a given time horizon, either over the next 12 months (12-month PD) or over the remaining lifetime (lifetime PD) of the obligation. In determining PD, the Bank performed segmentation of its credit exposures based on homogenous characteristics. PD of individually assessed credit exposures is determined based on the historical losses incurred over total exposure while PD of collectively assessed credit exposure is determined based on the net flow rate which is developed from historical movements between one days past due bucket to the next.

*(ii)* LGD pertains to estimate of loss related to the amount that may not be recovered after the borrower defaults. The Bank estimates LGD parameters based on historical recovery rates of claims against defaulted counterparties, which takes into consideration the realization of any collateral that is integral to the financial asset.

*(iii)* EAD represents the gross carrying amount of the exposure in the event of default which include the amortized cost of an instrument and any accrued interest receivable.

*(d) Overlay of Forward-looking Information*

The Bank incorporates forward-looking information (FLI) in its assessment of SICR and calculation of ECL. The Bank has performed historical analysis and has identified the key macroeconomic variables (MEVs) impacting credit risk associated with its borrowers.

The MEVs and their associated impact on the PD, LGD and EAD vary by financial instrument. The impact of these MEVs on the PD, LGD, and EAD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

The MEVs considered by the Bank includes economic data and forecasts published by government bodies (e.g., BSP and Philippine Statistics Authority). Accordingly, the Bank has identified key drivers for credit risk for each portfolio. Using an analysis on historical data, the Bank has estimated relationships between MEVs and credit risk and credit losses.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty, and therefore, the actual outcomes may be significantly different to those projections. The Bank considers these forecasts to represent its best estimate of the possible outcomes.

### *4.1.3 Credit Quality Analysis*

The following table sets out information about the credit quality of loans and receivables and investment in securities at amortized cost. As of December 31, 2019 and 2018, there are no POCI financial assets in the Bank's financial statements.

| | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **December 31, 2019** | | | | |
| **Loans and receivables:** | | | | |
| Performing: | | | | |
| Current | P 7,035,509,264 | P 339,035,742 | P 100,273,514 | P 7,474,818,520 |
| Past due | 60,195,069 | 36,162,526 | 519,945 | 96,877,540 |
| Non-performing: | | | | |
| Past due | - | - | 385,911,821 | 385,911,821 |
| Items in litigation | - | - | 144,131,177 | 144,131,177 |
| Gross carrying amount | 7,095,704,333 | 375,198,268 | 630,836,457 | 8,101,739,058 |
| Allowance for credit losses | ( 50,862,216) | ( 59,163,475) | ( 127,931,331) | ( 237,957,022) |
| | **P 7,044,842,117** | **P 316,034,793** | **P 502,905,126** | **P 7,863,782,036** |
| **Investment securities at amortized cost** | | | | |
| Grade BBB+ | P 294,723,281 | P - | P - | P 294,723,281 |
| | **P 7,339,565,398** | **P 316,034,793** | **P 502,905,126** | **P 8,158,505,317** |
| December 31, 2018 | | | | |
| Loans and receivables: | | | | |
| Performing: | | | | |
| Current | P 4,507,320,666 | P 146,934,911 | P1,743,104,182 | P 6,397,359,759 |
| Past due | - | 5,767,934 | 16,207,779 | 21,975,713 |
| Non-performing: | | | | |
| Past due | - | - | 444,791,860 | 444,791,860 |
| Items in litigation | - | - | 100,391,852 | 100,391,852 |
| Gross carrying amount | 4,507,320,666 | 152,702,845 | 2,304,495,673 | 6,964,519,184 |
| Allowance for credit losses | ( 49,819,551) | ( 6,265,414) | ( 192,769,260) | ( 248,854,225) |
| | P 4,457,501,115 | P 146,437,431 | P2,111,726,413 | P 6,715,664,959 |
| Investment securities at amortized cost | | | | |
| Grade BBB+ | P 529,700,546 | P - | P - | P 529,700,546 |
| | P 4,987,201,661 | P 146,437,431 | P2,111,726,413 | P 7,245,365,505 |

The Bank's management considers that all the above financial assets that are not impaired or past due at the end of each reporting period are of good credit quality.

*a. Due from BSP and Other Banks*

The credit risk for Due from BSP and other banks is considered negligible, since the counterparties are reputable banks. Due from other banks are insured by the Philippine Deposit Insurance Corporation (PDIC) up to a maximum coverage of P0.5 million per depositor per banking institution, as provided for under Republic Act (RA) No. 9576, *Amendment to Charter of PDIC*.

*b. Loans and Receivables*

In respect of loans and receivables, the Bank is not exposed to any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. Loans consist of a large number of customers in various geographical areas.

The carrying amount of loans and receivables as of December 31, 2019 and 2018, are presented under Note 8.

*c. Investment in securities at amortized cost*

The Bank's investment securities are with the government and large corporations whose exposure to credit risk is not deemed significant.

*d. Other Financial Assets*

The Bank is not exposed to significant credit risk on its other financial assets since the Bank expects these to be recovered in the normal course of business.

### *4.1.4 Allowance for Expected Credit Losses*

The following table show the reconciliation of the loss allowance for ECL on loans and receivables at the beginning and end of 2019 and 2018.

| | Stage 1 12-month ECL | Stage 2 Lifetime ECL | Stage 3 Lifetime ECL | Total |
|---|---|---|---|---|
| **December 31, 2019:** | | | | |
| ECL as at January 1, 2019 | P 49,819,551 | P 6,265,414 | P 192,769,260 | P 248,854,225 |
| Effect of merger | 10,105,388 | 2,346,605 | 137,644,587 | 150,096,580 |
| ECL balance after merger | 59,924,939 | 8,612,019 | 330,413,847 | 398,950,805 |
| Transfers from: | | | | |
| Stage 1 to 2 | ( 1,152,467) | 2,308,139 | - | 1,155,672 |
| Stage 1 to 3 | ( 2,663,861) | - | 13,758,527 | 11,094,666 |
| Stage 2 to 1 | 384,251 | ( 429,435) | - | ( 45,184) |
| Stage 2 to 3 | - | ( 5,926,495) | 5,926,495 | - |
| Stage 3 to 1 | 2,882,717 | - | ( 19,247,569) | ( 16,364,852) |
| Stage 3 to 2 | - | 55,387,600 | ( 66,573,166) | ( 11,185,566) |
| Changes in PDs/LGDs/EADs | ( 8,513,363) | ( 788,353) | ( 136,346,803) | ( 145,648,519) |
| Total net financial position charge | ( 9,062,723) | 50,551,456 | ( 202,482,516) | ( 160,993,783) |
| | **P 50,862,216** | **P 59,163,475** | **P 127,931,331** | **P 237,957,022** |
| December 31, 2018: | | | | |
| ECL as at January 1, 2018 | P 42,079,896 | P 7,299,011 | P 177,969,964 | P 227,348,871 |
| Transfers from: | | | | |
| Stage 1 to 2 | ( 982,399) | 3,546,535 | - | 2,564,136 |
| Stage 1 to 3 | ( 2,300,860) | - | 63,110,155 | 60,809,295 |
| Stage 2 to 1 | 57,649 | ( 455,374) | - | ( 397,725) |
| Stage 2 to 3 | - | ( 2,991,963) | 18,496,254 | 15,504,291 |
| Stage 3 to 1 | 68,235 | - | ( 729,640) | ( 661,405) |
| Stage 3 to 2 | - | 305,404 | ( 963,143) | ( 657,739) |
| Changes in PDs/LGDs/EADs | 10,897,030 | ( 1,438,199) | ( 65,114,330) | ( 55,655,499) |
| Total net financial position charge | 7,739,655 | ( 1,033,597) | 14,799,296 | 21,505,354 |
| | P 49,819,551 | P 6,265,414 | P 192,769,260 | P 248,854,225 |

### 4.1.5 Significant Changes in Gross Carrying Amount Affecting Allowance for ECL

The table below provides information how the significant changes in the gross carrying amount of loans and receivables in 2019 and 2018 contributed to the changes in the allowance for ECL.

| | Stage 1 12-month ECL | Stage 2 Lifetime ECL | Stage 3 Lifetime ECL | Total |
|---|---|---|---|---|
| **December 27, 2019:** | | | | |
| Gross amount as at January 1, 2019 | P 4,507,320,666 | P 152,702,845 | P2,304,495,673 | P 6,964,519,184 |
| Effect of merger | 809,291,191 | 93,930,728 | 170,397,704 | 1,073,619,623 |
| Gross balance after merger | 5,316,611,857 | 246,633,573 | 2,474,893,377 | 8,038,138,807 |
| Transfers from: | | | | |
| Stage 1 to 2 | ( 107,502,512) | 81,678,015 | - | ( 25,824,497) |
| Stage 1 to 3 | ( 142,648,502) | - | 105,183,940 | ( 37,464,562) |
| Stage 2 to 1 | 38,114,845 | ( 44,333,225) | - | ( 6,218,380) |
| Stage 2 to 3 | - | ( 51,623,111) | 43,713,807 | ( 7,909,304) |
| Stage 3 to 1 | 840,235,380 | - | ( 1,028,522,331) | ( 188,286,951) |
| Stage 3 to 2 | - | 152,359,994 | ( 2,347,508,433) | ( 2,195,148,439) |
| Changes in PDs/LGDs/EADs | 1,150,893,265 | ( 9,516,978) | 1,383,076,097 | 2,524,452,384 |
| Total net financial position charge | 1,779,092,476 | 128,564,695 | ( 1,844,056,920) | 63,600,251 |
| | **P 7,095,703,333** | **P 375,198,268** | **P 630,836,457** | **P 8,101,739,058** |
| December 31, 2018: | | | | |
| Gross amount as at January 1, 2018 | P 3,785,465,820 | P 161,713,430 | P1,636,097,743 | P 5,583,276,993 |
| Transfers from: | | | | |
| Stage 1 to 2 | ( 98,239,883) | 68,819,135 | - | ( 29,420,748) |
| Stage 1 to 3 | ( 230,085,976) | - | 184,743,575 | ( 45,342,401) |
| Stage 2 to 1 | 5,372,576 | ( 11,382,719) | - | ( 6,010,143) |
| Stage 2 to 3 | - | ( 53,324,575) | 43,264,743 | ( 10,059,832) |
| Stage 3 to 1 | 5,890,893 | - | ( 13,222,217) | ( 7,331,324) |
| Stage 3 to 2 | - | 26,498,202 | ( 2,011,925,910) | ( 1,985,427,708) |
| Changes in PDs/LGDs/EADs | 1,038,917,236 | ( 39,620,628) | 2,465,537,739 | 3,464,834,347 |
| Total net financial position charge | 721,854,846 | ( 9,010,585) | 668,397,930 | 1,381,242,191 |
| | P 4,507,320,666 | P 152,702,845 | P2,304,495,673 | P 6,964,519,184 |

### 4.1.6 Concentration of Credit Risk

The concentrations of credit risk by sector of the Bank's financial assets as of December 31, 2019 and 2018 are presented in the succeeding page.

Excessive concentration of lending poses undue risk on the Bank's asset quality. The Bank believes that good diversification across economic sectors and kinds of borrowers will lessen this risk.

To maintain the quality of its loan portfolio, the Bank keeps its risk tolerance limits on asset quality lower than the industry ratio and enforce a stringent policy on credit evaluation, review and monitoring.

The Bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk (gross of allowance for impairment) as of December 31, 2019 and 2018 are shown below.

| | Due from BSP and other banks | Loans receivables | Investment in securities at amortized cost | Other resources | Total |
|---|---|---|---|---|---|
| **2019** | | | | | |
| Financial intermediaries | P 1,311,697,520 | P - | P 294,723,281 | P 17,712,002 | P 1,624,132,803 |
| Wholesale and retail trade, household and consumption | - | 2,033,939,462 | - | - | 2,033,939,462 |
| Real estate | - | 281,927,556 | - | - | 281,927,556 |
| Agriculture, hunting and forestry | - | 1,314,725,966 | - | - | 1,314,725,966 |
| Other community, social and personal activities | - | 4,437,424,887 | - | 56,836,777 | 4,494,261,664 |
| | P 1,311,697,520 | P 8,068,017,871 | P 294,723,281 | P 74,548,779 | P 9,748,987,451 |
| **2018** | | | | | |
| Financial intermediaries | P 958,553,410 | P - | P 529,700,546 | P 186,958,884 | P 1,675,212,840 |
| Wholesale and retail trade, household and consumption | - | 1,382,183,346 | - | - | 1,382,183,346 |
| Agriculture, hunting and forestry | - | 1,555,793,718 | - | - | 1,555,793,718 |
| Other community, social and personal activities | - | 4,002,375,567 | - | 51,330,216 | 4,053,705,783 |
| | P 958,553,410 | P 6,940,352,631 | P 529,700,546 | P 238,289,100 | P 8,666,895,687 |

### *4.1.7 Collateral Held as Security and Other Credit Enhancements*

The Bank holds collateral against loans to borrower in the form of mortgage interests over properties, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. The Bank's collateral portfolio is presented in Note 8.

The Bank holds collateral against loans and advances to customers in the form of hold-out deposits, real estate mortgage, standby letters of credit or bank guaranty, government guaranty, chattel mortgage, assignment of receivables, pledge of equity securities, personal and corporate guaranty and other forms of security. Estimates of fair value are based on the value of collateral assessed at the time of borrowing and are generally updated annually.

Generally, collateral is not held over loans and advances to other banks, except when securities are held as part of repurchase and securities borrowing arrangements. Collateral is not usually held against trading and investment securities, and no such collateral was held as of December 31, 2019 and 2018.

The Bank's manner of disposing the collateral for impaired loans and receivables is normally through sale of these assets after foreclosure proceedings have taken place. The Bank does not generally use the non-cash collateral for its own operations.

There were no changes in the Bank's collateral policies in 2019 and 2018.

### *4.1.8 Modifications of Financial Assets*

In certain cases, the Bank modifies the terms of the loans provided to the borrowers due to commercial renegotiations, or for distressed loans, with a view of maximizing recovery of the contractual amount of obligation that the Bank is owed to. Restructuring policies and practices are based on indicators or criteria which, in the management's judgment, indicate that payment will most likely continue. Such policies are continuously reviewed and updated as necessary. Restructuring is most commonly applied to customer loans (see Note 8).

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Bank monitors the performance of the financial asset subsequent to its modification.

The Bank may determine that the credit risk has significantly improved after restructuring (in accordance with the new terms for six consecutive months or more), so that the assets are moved from Stage 3 or Stage 2.

The Bank continues to monitor if there is a subsequent SICR in relation to such modified assets through the use of specific models for modified assets.

### *4.1.9 Write-offs*

The Bank writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery of the financial asset. Indicators that there is no reasonable expectation of recovery include: cessation of enforcement activity; and, where the Bank's recovery method is through foreclosure of collateral and the value of the collateral is less than the outstanding contractual amounts of the financial assets to be written-off.

### *4.2 Liquidity Risk*

The Bank's policy is to maintain adequate liquidity at all times. This policy aims to honor all cash requirements on an ongoing basis and to avoid raising funds above market rates or through the forced sale of assets.

Liquidity risk is the risk that sufficient funds may not be available to adequately meet the credit demands of the Bank's customers and repay deposits on maturity. The Bank's objective in liquidity management is to ensure that the Bank has sufficient liquid financial assets at all times to meet obligations when they fall due, under both normal and stressed conditions, without incurring unacceptable losses that would be detrimental to the Bank's operations.

The Bank manages liquidity risk by maintaining a portfolio of highly liquid financial assets of appropriate quality to ensure short-term funding requirements are met regularly and in the event of unforeseen interruption of cash flows. Specifically, the Bank's liquidity risk management is focused on the matching of the maturities of its liquid financial assets and short-term liabilities. In addition, the Bank also seeks to maintain sufficient liquidity to take advantage of interest rate opportunities when this arises.

The settlement groupings of the Bank's financial assets and financial liabilities as of December 31, 2019 and 2018 are as follows:

| | Within One Year | Beyond One Year But Less Than Five Years | Beyond Five Years | Total |
|---|---|---|---|---|
| **2019:** | | | | |
| Resources: | | | | |
| Cash and other cash items | P 122,965,051 | P - | P - | P 122,965,051 |
| Due from BSP and other banks | 1,311,697,520 | - | - | 1,311,697,520 |
| Loans and discounts - net | 2,148,241,261 | 5,312,250,171 | 582,203,939 | 8,042,695,371 |
| Investment securities at amortized cost | 169,717,474 | 115,312,937 | 9,692,870 | 294,723,281 |
| Other resources - net | 32,356,399 | 26,581,434 | 484,000 | 59,421,833 |
| | 3,784,977,705 | 5,454,144,542 | 592,380,809 | 9,831,503,056 |
| Liabilities: | | | | |
| Deposit liabilities | 4,102,395,927 | 322,128,410 | 869,239,920 | 5,293,764,257 |
| Bills payable | 1,266,621,637 | 783,854,588 | 35,150,843 | 2,085,627,068 |
| Lease liabilities | 18,192,356 | 50,549,939 | 100,497,538 | 169,239,833 |
| Accrued expenses and other liabilities | 418,533,418 | - | - | 418,533,418 |
| | 5,805,743,338 | 1,156,532,937 | 1,004,888,301 | 7,967,164,576 |
| **Net Periodic Gap** | **( 2,020,765,633)** | **4,297,611,605** | **( 412,507,492)** | **P1,864,338,480** |
| **Cumulative Total Gap** | **(P 2,020,765,633)** | **P 2,276,845,972** | **P1,864,338,480** | **P -** |
| 2018: | | | | |
| Resources: | | | | |
| Cash and other cash items | P 74,911,233 | P - | P - | P 74,911,233 |
| Due from BSP and other banks | 958,553,410 | - | - | 958,553,410 |
| Loans and discounts - net | 1,461,459,023 | 4,982,256,520 | 419,926,508 | 6,863,642,051 |
| Investment securities at amortized cost | 445,025,033 | 75,000,000 | 9,675,513 | 529,700,546 |
| Other resources - net | 209,616,213 | 20,971,563 | - | 230,587,776 |
| | 3,149,564,912 | 5,078,228,083 | 429,602,021 | 8,657,395,016 |
| Liabilities: | | | | |
| Deposit liabilities | 3,619,435,550 | 422,522,539 | 116,386,423 | 4,158,344,512 |
| Bills payable | 1,386,075,329 | 1,075,433,437 | - | 2,461,508,766 |
| Accrued expenses and other liabilities | 433,351,556 | - | - | 433,351,556 |
| | 5,438,862,435 | 1,497,955,976 | 116,386,423 | 7,053,204,834 |
| Net Periodic Gap | ( 2,289,297,523) | 3,580,272,107 | 313,215,598 | P1,604,190,182 |
| Cumulative Total Gap | (P2,289,297,523) | P 1,290,974,584 | P1,604,190,182 | P - |

The Bank continually assesses business opportunities and strategies where it can effectively and sufficiently match its short-term funding requirements with adequate liquid assets through taking customers' deposits with longer maturities and discounting loans to other financial institutions with repayments terms enough to cover credit demands of customers.

### *4.2.1 Minimum Liquidity Ratio*

On February 8, 2018, the BSP issued Circular No. 996, *Amendments to the Liquidity Coverage Ratio Framework for Stand-Alone Thrift Banks, Rural Banks, Cooperative Banks and Quasi-Banks*, which provide guidance on and prescribes the prudential requirement for covered institutions to maintain eligible stock of liquid assets proportionate to the level of total qualifying liabilities (i.e., both on and off-balance sheet liabilities). Eligible liquid assets shall include cash and other liquid assets that are immediately liquefiable and free from encumbrances.

The minimum liquidity ratio (MLR) of 20% shall be complied with on an ongoing basis absent a period of financial stress effective January 1, 2019.

The Bank's MLR as of December 31, 2019 are analyzed below.

| | |
|---|---|
| Eligible stock of liquid assets | P 1,729,385,852 |
| Total qualifying liabilities | 8,001,187,720 |
| MLR | **21.6%** |

### *4.3 Foreign Currency Risk*

The Bank has no significant exposure to foreign currency risks as most transactions are denominated in Philippine pesos, its functional currency.

### *4.4 Interest Rate Risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Bank's cash flow interest rate risk relates primarily to the possible changes in the prevailing interest rates on amounts due from other banks, investment securities at amortized cost and deposit liabilities that are subject to variable interest rates (see Notes 6, 7 and 13). The volatility in the interest rates of these financial instruments will result to an increase or decrease of the Bank's interest spread, and consequently will affect its financial performance. All other financial assets and financial liabilities either have fixed rates or non-interest bearing; hence, were not considered in the cash flow interest rate risk sensitivity.

The table in the succeeding page illustrates the sensitivity of the Bank's profit before tax and equity to a reasonably possible change in interest rates as at December 31, 2019 and 2018. These changes are considered to be reasonably possible based on observation of current market conditions. The calculations are based on a change in the average market interest rate for each period, and the financial instruments held at the end of each reporting period that are sensitive to changes in interest rates. All other variables are held constant.

| | Observed Volatility Rates | | Impact of Increase | | Impact of Decrease | |
|---|---|---|---|---|---|---|
| | Increase | Decrease | Profit Before Tax | Equity | Profit Before Tax | Equity |
| December 31, 2019 | | | | | | |
| Cash and cash equivalents | +1.66% | -1.66% | P 11,736,353 | P 9,389,082 | (P 11,736,353) | (P 9,389,082) |
| Investment securities at amortized cost | +2.46% | -2.46% | 5,030,441 | 4,024,353 | ( 5,030,441) | ( 4,024,353) |
| Deposit liabilities | +1.66% | -1.66% | ( 76,073,712) | ( 60,858,970) | 76,073,712 | 60,858,970 |
| | | | (P 59,306,918) | (P 47,445,535) | P 59,306,918 | P 47,445,535 |
| December 31, 2018 | | | | | | |
| Cash and cash equivalents | +1.66% | -1.66% | P 11,492,458 | P 9,193,966 | (P 11,492,458) | (P 9,193,966) |
| Investment securities at amortized cost | +2.46% | -2.46% | 15,680,752 | 12,544,602 | ( 15,680,752) | ( 12,544,602) |
| Deposit liabilities | +1.66% | -1.66% | ( 87,962,813) | ( 70,370,250) | 87,962,813 | 70,370,250 |
| | | | (P 60,789,603) | (P 48,631,682) | P 60,789,603 | P 48,631,682 |

To mitigate this risk, the Bank follows a prudent policy in managing assets and liabilities in order to ensure that exposure to interest rate risk are kept within acceptable levels.

### *4.5 Operational Risk*

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, or may lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage this risk. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff training and assessment processes, including the maintenance of internal audit.

### *4.6 Anti-Money Laundering Controls*

The Anti-Money Laundering Act (AMLA) or RA No. 9160 was passed in September 2001 and was amended by RA No. 9194, RA No. 10167, and RA No. 10365 in March 2003, June 2012 and February 2013, respectively. Under the AMLA, as amended, the Bank is required to submit "Covered Transaction Reports" to the Anti-Money Laundering Council (AMLC) involving single transactions in cash or other equivalent monetary instruments in excess of P0.50 million within one banking day. The Bank is also required to submit "Suspicious Transaction Reports" to the AMLC in the event that circumstances exist and there are reasonable grounds to believe that the transaction is suspicious. Furthermore, terrorist financing was criminalized in RA No. 10168.

In addition, the AMLA requires that the Bank safe keeps, as long as the account exists, all the Know Your Customer (KYC) documents involving its clients, including documents that establish and record the true and full identity of its clients. Likewise, transactional documents must be maintained and stored for five years from the date of the transaction. In cases involving closed accounts, the KYC documents must be kept for five years after their closure. Meanwhile, all records of accounts with court cases must be safe kept until there is a final resolution.

On January 27, 2011, BSP Circular No. 706 (the Circular) was implemented superseding all policies on AMLA. The Circular requires the Bank to adopt a comprehensive and risk-based Money Laundering and Terrorist Financing Prevention Program (MLPP) designed according to the covered institution's corporate structure and risk profile.

The Compliance Unit of the Bank, headed by the Chief Compliance Officer (CCO), monitors the Bank's compliance on the implementation and management of MLPP. The Branch Operations Head is the compliance officer at the branch level, that oversees the daily activities of the branch. The CCO regularly reports to the Audit Committee and to the BOD the results of their monitoring of AMLA compliance.

In an effort to further prevent money laundering activities, the Bank strengthens its KYC policies and guidelines. New individual customers shall establish their true and full identity, and shall maintain an account only in the true and full name of the account owner. Likewise, the Bank is required to risk profile its clients to Low, Normal or High with its corresponding due diligence of Reduced, Average or Enhanced, in compliance with the risk-based approach mandated by the Circular. Politically Exposed Persons are automatically profiled as high risk and subject to enhanced due diligence. Any suspicious transaction is reported to the Bank's AML Committee, who investigates and deliberates whether the transaction has a valid ground to be reported as Suspicious Transaction Report.

## 5. CATEGORIES, FAIR VALUES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

### *5.1 Carrying Amounts and Fair Values by Category*

The carrying amounts and fair values of the categories of financial assets and financial liabilities presented in the statements of financial position are shown below.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Carrying Amounts** | **Fair Values** | Carrying Amounts | Fair Values |
| *Financial Assets* | | | | |
| At amortized cost: | | | | |
| Cash and other cash items | **P 122,965,051** | **P 122,965,051** | P 74,911,233 | P 74,911,233 |
| Due from BSP | **291,928,290** | **291,928,290** | 370,499,440 | 370,499,440 |
| Due from other banks | **1,019,769,230** | **1,019,769,230** | 588,053,970 | 588,053,970 |
| Loans and discounts - net | **8,042,695,371** | **13,547,991,824** | 6,863,632,051 | 10,641,631,399 |
| Investments securities at amortized cost | **294,723,281** | **309,923,580** | 529,700,546 | 529,700,546 |
| Other resources - net | **59,421,833** | **59,421,833** | 230,587,776 | 230,587,776 |
| | **P 9,831,503,056** | **P 15,351,999,808** | P 8,657,385,016 | P 12,435,384,364 |
| *Financial Liabilities* | | | | |
| At amortized cost: | | | | |
| Deposit liabilities | **P5,293,764,257** | **P5,293,764,257** | P 4,158,344,512 | P 4,158,344,512 |
| Bills payable | **2,085,627,068** | **2,043,226,392** | 2,461,508,766 | 2,461,508,766 |
| Lease liabilities | **169,239,833** | **169,239,833** | - | - |
| Accrued expenses and other liabilities | **418,533,418** | **418,533,418** | 433,351,556 | 433,351,556 |
| | **P 7,967,164,576** | **P 7,924,763,900** | P 7,053,204,834 | P 7,053,204,834 |

See Notes 2.3 and 2.8 for a description of the accounting policies for each category of financial instruments. A description of the Bank's risk management objectives and policies for financial instruments is provided in Note 4.

### *5.2 Offsetting Financial Assets and Financial Liabilities*

The Bank's loans and discounts secured through hold-out on deposits, and bills payable secured through loans are the only financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements. However, the Bank does not present such loans and discounts net of the deposit liabilities or bills payable net of the loans and discounts used as collateral in the statements of financial position. The table below show the gross amounts presented in the financial statements:

| | Gross amounts recognized in the statements of financial position | Related amounts not set off in the statements of financial position: Financial Instruments | Related amounts not set off in the statements of financial position: Collateral received | Net amount |
|---|---|---|---|---|
| **2019:** | | | | |
| Financial assets – | | | | |
| Loans and discounts | **P 8,042,695,371** | **(P 2,150,557,472)** | **P -** | **P 5,892,137,899** |
| Financial liabilities: | | | | |
| Deposits | **5,295,796,976** | **( 64,930,404)** | **-** | **5,230,866,572** |
| Bills payable | **2,085,627,068** | **( 2,085,627,068)** | **-** | **-** |
| **2018:** | | | | |
| Financial assets – | | | | |
| Loans and discounts | P 6,863,642,051 | (P 1,885,405,335) | P - | P 4,978,236,716 |
| Financial liabilities: | | | | |
| Deposits | 4,158,344,512 | ( 5,450,363) | - | 4,152,894,149 |
| Bills payable | 2,461,508,766 | ( 1,879,954,972) | - | 581,553,794 |

For financial assets subject to enforceable master netting arrangements or similar arrangements between the Bank and counterparties, it allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such election, financial assets and financial liabilities will be settled on a gross basis; however, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

For purposes of presenting the information in the preceding page, the related amounts not set-off in the statements of financial position pertains to: (a) deposit hold-out which serves as the Bank's collateral enhancement for certain loans and receivables; and, (b) certain loans and receivables assigned by the Bank as collateral for its bills payable. The financial instruments that can be set-off are only disclosed to the extent of the amounts of the Bank's counterparties.

### *5.3 Fair Value Hierarchy*

In accordance with PFRS 13, *Fair Value Measurement*, the fair value of financial assets and liabilities and non-financial assets which are measured at fair value on a recurring or non-recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and,

- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

For purposes of determining the market value at Level 1, a market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

For investments which do not have quoted market price, the fair value is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Bank uses valuation technique, it maximizes the use of observable market data where it is available and relies as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2. Otherwise, it is included in Level 3.

### *5.3.1 Financial Instruments Measured at Amortized Cost for which Fair Value is Disclosed*

The table below and in the succeeding page summarizes the fair value hierarchy of the Bank's financial assets and financial liabilities which are not measured at fair value in the statements of financial position but for which fair value is disclosed.

| | Notes | 2019 Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| ***Financial assets*** | | | | | |
| At amortized cost: | | | | | |
| Cash and other cash items | 6 | P 122,965,051 | P - | P - | P 122,965,051 |
| Due from BSP | 6 | 291,928,290 | - | - | 291,928,290 |
| Due from other banks | 6 | 1,019,769,230 | - | - | 1,019,769,230 |
| Loans and discounts | 8 | - | - | 13,547,991,824 | 13,547,991,824 |
| Investment securities at amortized cost | 7 | 294,652,864 | - | 70,417 | 294,723,281 |
| Other resources - net | 12 | - | - | 78,972,687 | 78,972,687 |
| | | P 1,729,315,435 | P - | P13,627,034,928 | P15,536,350,363 |
| ***Financial liabilities*** | | | | | |
| At amortized cost: | | | | | |
| Deposit liabilities | 13 | P - | P - | P 5,293,764,257 | P 5,293,764,257 |
| Bills payable | 14 | - | - | 2,085,627,068 | 2,085,627,068 |
| Lease liabilities | 10 | - | - | 169,239,833 | 169,239,833 |
| Accrued expenses and other liabilities | 15 | - | - | 418,533,418 | 418,533,418 |
| | | P - | P - | P 7,967,164,576 | P 7,967,164,576 |

| | Notes | 2018 Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|---|
| *Financial assets* | | | | | |
| At amortized cost: | | | | | |
| Cash and other cash items | 6 | P 74,911,233 | P - | P - | P 74,911,233 |
| Due from BSP | 6 | 370,499,440 | - | - | 370,499,440 |
| Due from other banks | 6 | 588,053,970 | - | - | 588,053,970 |
| Loans and discounts | 8 | - | - | 10,641,631,399 | 10,641,631,399 |
| Investment securities at amortized securities | 7 | 529,700,546 | - | - | 529,700,546 |
| Other resources - net | 12 | - | - | 433,351,556 | 433,351,556 |
| | | P 1,563,165,189 | P - | P11,074,982,955 | P12,638,148,144 |
| *Financial liabilities* | | | | | |
| At amortized cost: | | | | | |
| Deposit liabilities | 13 | P - | P - | P 4,158,344,512 | P 4,158,344,512 |
| Bills payable | 14 | - | - | 2,461,508,766 | 2,461,508,766 |
| Accrued expenses and other liabilities | 15 | - | - | 433,351,556 | 433,351,556 |
| | | P - | P - | P 7,053,204,834 | P 7,053,204,834 |

The Bank has certain financial assets and financial liabilities measured at amortized cost as of the end of the reporting period whose related fair value are disclosed. For financial assets and financial liabilities whose fair values are included in Level 1, management considers that the carrying amounts of those short-term financial instruments approximate their fair values.

The fair values of the financial assets and financial liabilities included in Level 2 and 3 above which are not traded in an active market is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market value of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

### *5.3.2 Fair Value Disclosures for Non-Financial Assets*

The total estimated fair values of the Bank's assets held for sale amounted to P4.9 million and P5.3 million as of December 31, 2019 and 2018, respectively (see Note 12.6). The fair values of the Bank's assets held for sale classified under Other Resources account are determined on the basis of the appraisals performed by the internal appraisers with appropriate qualifications and recent experience in the valuation of similar properties. In estimating the fair value of these properties, management takes into account the market participant's ability to generate economic benefits by using the assets in their highest and best use.

A significant change in key inputs and sources of information used in the determination of the fair value disclosed for those assets may result in adjustment in the carrying amount of the assets reported in the financial statements if their fair value will indicate evidence of impairment.

The fair values of the Bank's land and buildings classified under investment properties were determined based on the following approaches:

*(a) Fair Value Measurement for Land*

The Level 3 fair value of land was derived using the observable recent prices of the reference properties and were adjusted for differences in key attributes such as property size, zoning, and accessibility. The most significant input into this valuation approach is the price per square meter; hence, the higher the price per square meter, the higher the fair value of the properties.

(b) *Fair Value Measurement for Buildings*

The Level 3 fair value of the buildings was determined using the cost approach that reflects the cost to a market participant to construct an asset of comparable usage, construction standards, design and layout, adjusted for obsolescence. The most significant inputs used in the valuation include direct and indirect costs of construction such as but not limited to, labor and contractor's profit, materials and equipment, surveying and permit costs, electricity and utility costs, architectural and engineering fees, insurance and legal fees. These inputs were derived from various suppliers and contractor's quotes, price catalogues, and construction price indices. Under this approach, higher estimated costs used in the valuation will result in higher fair value of the properties.

(c) *Fair Value Measurement for Motor Vehicles and Jewelries*

The Level 3 fair value of the motor vehicles and jewelries was determined based on the appraisal report of internal appraisers. Fair value was determined based on the replacement cost of an asset with an equally satisfactorily substitute asset which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential.

There has been no change to the valuation techniques used by the Bank during the year for its non-financial assets. Also, there were no transfers into or out of Level 3 fair value hierarchy in 2019 and 2018.

## 6. CASH AND CASH EQUIVALENTS

The components of cash and cash equivalents are as follows:

| | Note | **2019** | 2018 |
|---|---|---|---|
| Cash and other cash items | 6.1 | **P 122,965,051** | P 74,911,233 |
| Due from BSP | 6.2 | **291,928,290** | 370,499,440 |
| Due from other banks | 6.3 | **1,019,769,230** | 588,053,970 |
| | | **P1,434,662,571** | P1,033,464,643 |

### *6.1 Cash and Other Cash Items*

These represent the total amount of cash in the Bank's vault in the form of Philippine currency and checks and other cash items received after the cut-off time until the close of the regular banking hours.

### *6.2 Due from BSP*

Due from BSP represents the deposit balance maintained with the BSP to meet reserve requirements. Based on BSP Circular No. 1063, *Reduction in Reserve Requirements*, dated November 21, 2019, the required reserves against deposit and deposit substitute liabilities shall be four percent (4.00%) for demand, savings and time deposits (see Note 13). The composition of the required reserves shall be demand deposits with the BSP. Deposits maintained by banks with the BSP in compliance with the reserve requirement are noninterest-bearing.

### *6.3 Due from Other Banks*

Due from other banks maintained under savings, demand, and time accounts are as follows:

| | 2019 | 2018 |
|---|---|---|
| Commercial banks: | | |
| Savings | **P 385,548,005** | P 296,641,943 |
| Demand | **54,467,265** | 28,668,245 |
| Time | **36,326,641** | - |
| | **476,341,911** | 325,310,188 |
| Government banks: | | |
| Savings | **66,122,794** | 60,011,387 |
| Demand | **381,418,146** | 165,070,945 |
| Time | **95,886,379** | 37,661,450 |
| | **543,427,319** | 262,743,782 |
| | **P1,019,769,230** | P 588,053,970 |

Interest rates on these deposits range from 0.25% to 1.50% per annum both in 2019 and 2018. Interest income earned from due from other banks amounting to P0.9 million both in 2019 and 2018 is shown as Interest Income on Due from Other Banks in the statements of comprehensive income.

## 7. INVESTMENT SECURITIES AT AMORTIZED COST

The account consists of peso-denominated treasury bonds which bear fixed interest rates ranging from 3.93% to 5.96% in 2019 and 1.89% to 4.96% in 2018 per annum, and will mature within 1 to 20 years.

Interest income earned from investment securities at amortized cost in 2019 and 2018 amounting to P28.2 million and P17.3 million, respectively, is shown as Interest Income on Investment Securities at Amortized Cost in the statements of comprehensive income.

| | Note | 2019 | 2018 |
|---|---|---|---|
| Balance at beginning of year | | **P 529,700,546** | P 334,655,592 |
| Effect of merger | 1.2 | **90,383,354** | - |
| Additions | | **164,998,019** | 504,984,078 |
| Periodic maturities collected | | **( 489,984,860)** | ( 314,995,793) |
| Discount (premium) amortization | | **( 373,778)** | 5,056,669 |
| Balance at end of year | | **P 294,723,281** | P 529,700,546 |

The maturity profile of the investment securities at amortized cost are as follows:

| | 2019 | 2018 |
|---|---|---|
| Within one year | **P 169,717,474** | P 445,025,033 |
| Beyond one year but less than five years | **115,312,937** | 75,000,000 |
| Beyond five years | **9,692,870** | 9,675,513 |
| Balance at end of year | **P 294,723,281** | P 529,700,546 |

## 8. LOANS AND DISCOUNTS

This account is comprised of:

| | 2019 | 2018 |
|---|---|---|
| Loans and discounts | **P8,101,739,058** | P 6,964,519,184 |
| Unearned interests and discounts | **( 33,721,187)** | ( 24,166,553) |
| | **8,068,017,871** | 6,940,352,631 |
| Allowance for impairment | **( 237,957,022)** | ( 248,854,225) |
| Net loans and discount | **7,830,060,849** | 6,691,498,406 |
| Accrued interest receivable | **212,634,522** | 172,143,645 |
| | **P8,042,695,371** | P6,863,642,051 |

The balance of loans and discounts include non-accruing loans amounting to P676.4 million and P544.9 million as of December 31, 2019 and 2018, respectively.

Interest rates on receivables from customers range from 6.00% to 30.00% per annum in 2019 and 2018.

Interest income earned from loans and discounts amounting to P1.04 billion and P930.1 million in 2019 and 2018, respectively, is shown as Interest Income on Loans and receivables account in the statements of comprehensive income.

Loans and discounts amounting to P2.4 billion and P1.9 billion as of December 31, 2019 and 2018, respectively, are assigned to bills payable for rediscounting availments. The related liabilities are not set-off in the financial statements but are subject to offsetting arrangements (see Notes 5.2 and 14).

The maturity profile of the total gross loans and discounts follows:

| | 2019 | 2018 |
|---|---|---|
| Within one year | **P1,103,332,256** | P1,603,190,100 |
| Beyond one year but less than five years | **4,835,731,327** | 4,896,575,876 |
| Beyond five years | **2,162,675,475** | 464,753,208 |
| | **P8,101,739,058** | P6,964,519,184 |

All of the Bank's loans and discounts have been subjected to credit risk assessment as disclosed in Note 4.1. A reconciliation of allowance for impairment at the beginning and end of the reporting period is shown below.

| | Note | **2019** | 2018 |
|---|---|---|---|
| Balance at beginning of year | | **P 248,854,225** | P 227,348,872 |
| Effect of merger | 1.2 | **184,738,085** | - |
| Impairment losses (recovery) | | **( 195,635,288)** | 134,481,778 |
| Write-offs | | **-** | ( 112,976,425) |
| Balance at end of year | | **P 237,957,022** | P 248,854,225 |

Impairment losses are presented as part of Impairment Losses in the statements of comprehensive income.

## 9. BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

The gross carrying amounts and accumulated depreciation and amortization of bank premises, furniture, fixtures and equipment at the beginning and end of the reporting period are shown below.

| | Land | Building | Transportation Equipment | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
|---|---|---|---|---|---|---|
| December 31, 2019 | | | | | | |
| Cost | P 31,095,066 | P 118,974,283 | P 103,997,165 | P 141,608,763 | P 138,998,525 | P 534,673,802 |
| Revaluation increment | 8,602,577 | 927,389 | - | - | - | 9,529,966 |
| Accumulated depreciation and amortization | - | ( 63,304,173) | ( 73,863,332) | ( 117,611,848) | ( 90,841,024) | ( 345,620,377) |
| Net carrying amount | **P 39,697,643** | **P 56,597,499** | **P 30,133,833** | **P 23,996,915** | **P 48,157,501** | **P 198,583,391** |
| December 31, 2018 | | | | | | |
| Cost | P 17,963,677 | P 79,370,518 | P 89,492,371 | P 144,518,300 | P 70,434,674 | P 401,779,540 |
| Accumulated depreciation and amortization | - | ( 48,614,207) | ( 65,997,464) | ( 129,554,849) | ( 47,419,429) | ( 291,585,949) |
| Net carrying amount | P 17,963,677 | P 30,756,311 | P 23,494,907 | P 14,963,451 | P 23,015,245 | P 110,193,591 |
| January 1, 2018 | | | | | | |
| Cost | P 17,963,677 | P 44,936,456 | P 56,895,585 | P 80,190,911 | P 47,518,475 | P 247,505,104 |
| Accumulated depreciation and amortization | - | ( 13,204,539) | ( 36,173,689) | ( 63,949,054) | ( 23,928,149) | ( 137,255,431) |
| Net carrying amount | P 17,963,677 | P 31,731,917 | P 20,721,896 | P 16,241,857 | P 23,590,326 | P 110,249,673 |

A reconciliation of the carrying amounts of bank premises, furniture, fixtures and equipment at the beginning and end of the reporting period is shown below.

| | Land | Building | Transportation Equipment | Furniture, Fixtures and Equipment | Leasehold Improvements | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2019, net of accumulated depreciation and amortization | P 17,963,677 | P 30,756,311 | P 23,494,907 | P 14,963,451 | P 23,015,245 | P 110,193,591 |
| Additions | 3,800,125 | 15,403,944 | 12,928,369 | 14,410,430 | 8,707,951 | 55,250,819 |
| Transfer from merger | 17,933,841 | 25,181,560 | 4,654,033 | 7,575,603 | 21,042,788 | 76,387,825 |
| Disposals | - | - | ( 64 ) | - | - | ( 64) |
| Reclassifications | - | ( 12,013,640) | ( 306,890 ) | ( 991,662) | 3,056,555 | ( 10,255,637 ) |
| Depreciation and amortization charges for the year | - | ( 2,730,676) | ( 10,636,522) | ( 11,960,907) | ( 7,665,038) | ( 32,993,143) |
| Balance at December 31, 2019, net of accumulated depreciation and amortization | P 39,697,643 | P 56,597,499 | P 30,133,833 | P 23,996,915 | P 48,157,501 | P 198,583,391 |
| Balance at January 1, 2018, net of accumulated depreciation and amortization | P 17,963,677 | P 31,731,917 | P 20,721,896 | P 16,241,857 | P 23,590,326 | P 110,249,673 |
| Additions | - | 8,231,167 | 14,108,669 | 12,468,014 | 378,316 | 35,186,166 |
| Disposals | - | - | ( 28,805 ) | - | - | ( 28,805) |
| Reclassifications | - | ( 5,766,306) | ( 406,988 ) | ( 12,229) | 6,260,365 | 74,842 |
| Depreciation and amortization charges for the year | - | ( 3,440,467 ) | ( 10,899,865) | ( 13,734,191) | ( 7,213,762) | ( 35,288,285) |
| Balance at December 31, 2018, net of accumulated depreciation and amortization | P 17,963,677 | P 30,756,311 | P 23,494,907 | P 14,963,451 | P 23,015,245 | P 110,193,591 |

Certain fully depreciated assets costing P157.6 million and P206.3 million as of December 31, 2019 and 2018, are still being used in operations.

Total depreciation and amortization charges amounting to P32,993,143 and P35,288,285 in 2019 and 2018, respectively, are presented as part of Depreciation under Other Expenses in the statements of comprehensive income (see Note 17.2).

The BSP requires that investments in fixed assets do not exceed 50% of the Bank's unimpaired capital. As of December 31, 2019 and 2018, the Bank has satisfactorily complied with this BSP requirement.

## 10. LEASES

The Bank has leases for certain office spaces. With the exception of short-term leases, each lease is reflected on the 2019 statement of financial position as a right-of-use asset and a lease liability.

Each lease generally imposes a restriction that, unless there is a contractual right for the Bank to sublet the asset to another party, the right-of-use asset can only be used by the Bank. Leases are either non-cancellable or may only be cancelled by incurring a substantive termination fee. The Bank is prohibited from selling or pledging the underlying leased assets as security and they must keep those properties in a good state of repair and return the properties in their original condition at the end of the lease. Further, the Bank must insure the leased assets and incur maintenance fees on such items in accordance with the lease contracts.

The Bank's leasing activities on office spaces have remaining terms ranging from 11 to 15 years.

### *10.1 Right-of-use Assets*

The carrying amount of the Bank's right-of-use assets as at December 31, 2019 and the movements during the year are shown below.

| | Notes | |
|---|---|---|
| Balance at the beginning of the year | 2.2 (a)(iv) | P 85,816,114 |
| Effect of merger | 1.2 | 22,766,294 |
| Additions | | 73,283,101 |
| Amortization | 17.2 | ( 19,405,605) |
| Balance at end of year | | P 162,459,904 |

### *10.2 Lease Liabilities*

Lease liabilities amounting to P169.2 million is presented as Lease Liabilities in the 2019 statement of financial position.

The use of extension and termination options gives the Bank added flexibility in the event it has identified more suitable premises in terms of cost and/or location or determined that it is advantageous to remain in a location beyond the original lease term. As at December 31, 2019, the terms of the lease contracts of the Bank are renewable upon mutual agreement of the parties.

| | Note | |
|---|---|---|
| Balance at the beginning of the year | 2.2 (a)(iv) | P 85,816,114 |
| Effect of merger | | 23,979,024 |
| Additions | | 73,283,101 |
| Payments | | ( 20,662,388) |
| Amortization of interest | | 6,823,982 |
| Balance at end of year | | P 169,239,833 |

As of December 31, 2019, the Bank had not committed to any lease which had not yet commenced.

The lease liabilities are secured by the related underlying assets. The undiscounted maturity analysis of lease liabilities as at December 31, 2019 is as follows:

| | Within 1 Year | 1 to 2 Years | 2 to 3 Years | 3 to 4 Years | 4 to 5 Years | 5 to 10 Years | 10 or More Years | Total |
|---|---|---|---|---|---|---|---|---|
| Lease payments | P28,083,924 | P23,284,667 | P21,475,000 | P19,593,658 | P15,635,027 | P 66,470,621 | P 83,239,420 | P257,782,317 |
| Finance charges | ( 9,891,568) | ( 8,876,584) | ( 8,038,036) | ( 7,247,760) | ( 6,590,992) | ( 25,457,229) | ( 22,440,315) | ( 88,542,484) |
| Net present value | P18,192,356 | P14,408,083 | P13,436,964 | P12,345,898 | P 9,044,035 | P 41,013,392 | P 60,799,105 | P169,239,833 |

### *10.3 Lease Payments Not Recognized as Liabilities*

The Bank has elected not to recognize a lease liability for the short-term leases. Expenses relating to short-term leases amounted to P3.9 million and is presented as Rent under of Operating Expenses in the 2019 statement of comprehensive income (see Note 17.2).

### *10.4 Additional Profit or Loss and Cash Flow Information*

The total cash outflow in respect of leases amounted to P24.6 million in 2019. Interest expense in relation to lease liabilities amounted to P6.6 million and is presented as part of Interest Expense Others in the 2019 statement of comprehensive income.

## 11. INVESTMENT PROPERTIES

The Bank's investment properties include parcels of land and buildings acquired principally through foreclosures.

The gross carrying amounts and cumulative fair value adjustments of investment properties presented in the statements of financial position as at December 31, 2019 and 2018 are shown below.

| | Land | Buildings | Total |
|---|---|---|---|
| December 31, 2019 | | | |
| Cost | P 129,905,959 | P 22,155,152 | P152,061,111 |
| Effect of merger | 48,069,756 | - | 48,069,756 |
| Accumulated impairment | ( 11,521,619) | - | ( 11,521,619) |
| Accumulated depreciation | - | ( 8,898,046) | ( 8,898,046) |
| | **P 166,454,096** | **P 13,257,106** | **P179,711,202** |
| December 31, 2018 | | | |
| Cost, as reported | P 184,808,496 | P 32,739,643 | P217,548,139 |
| Effect of change in accounting policy | ( 73,522,589) | 5,896,642 | ( 67,625,947) |
| Cost, as restated | 111,285,907 | 38,636,285 | 149,922,192 |
| Accumulated depreciation, as restated | - | ( 10,393,658) | ( 10,393,658) |
| | P 111,285,907 | P 28,242,627 | P139,528,534 |
| January 1, 2018 | | | |
| Cost, as reported | P 186,883,354 | P 39,052,080 | P225,935,434 |
| Effect of change in accounting policy | ( 87,873,319) | ( 19,528,580) | ( 107,401,899) |
| Cost, as restated | 99,010,035 | 19,523,500 | 118,533,535 |
| Accumulated depreciation, as restated | - | ( 7,762,983) | ( 7,762,983) |
| | P 99,010,035 | P 11,760,517 | P110,770,552 |

A reconciliation of the carrying amounts of investment properties at the beginning and end of 2019 and 2018 is shown below.

| | Land | Buildings | Total |
|---|---|---|---|
| Balance at January 1, 2019 | P 111,285,907 | P 28,242,627 | P139,528,534 |
| Additions | 18,197,443 | 5,371,650 | 23,569,093 |
| Effect of merger | 77,476,652 | 6,460,166 | 83,936,818 |
| Disposals | ( 40,505,906) | ( 25,465,148) | ( 65,971,054) |
| Depreciation | - | ( 1,352,189) | ( 1,352,189) |
| Balance at December 31, 2019 | **P 166,454,096** | **P 13,257,106** | **P179,711,202** |
| Balance at January 1, 2018, as reported | P 186,883,354 | P 39,052,080 | P225,935,434 |
| Effect of change in accounting policy | ( 87,873,319) | ( 27,291,563) | ( 115,164,882) |
| Balance at January 1, 2018 as restated | 99,010,035 | 11,760,517 | 110,770,552 |
| Additions | 57,233,991 | 18,176,954 | 75,410,945 |
| Disposals | ( 44,958,119) | - | ( 44,958,119) |
| Depreciation | - | ( 1,694,844) | ( 1,694,844) |
| Balance at December 31, 2018 | P 111,285,907 | P 28,242,627 | P139,528,534 |

The Bank sold certain investment properties with total gross carrying amount of P66.0 million for P71.7 million and P45.0 million for P41.6 million in 2019 and 2018, respectively. As a result, the Bank recognized a gain on sale amounting to P5.0 million in 2019 and loss on sale amounting to P5.7 million in 2018, which is presented as Gain (loss) on sale of non-financial assets under Other Income account in the statements of comprehensive income (see Note 17.1).

Fair market value of investment properties amounted to P259.1 million and P217.5 million as at December 31, 2019 and 2018, respectively (see Note 5.3.2).

## 12. OTHER RESOURCES

This account consists of:

| | Notes | 2019 | 2018 |
|---|---|---|---|
| Deferred tax assets | 19 | **P 30,518,832** | P 95,150,461 |
| Sales contract receivable | 12.2 | **31,461,757** | 27,650,919 |
| Accounts receivable | 12.1 | **25,375,020** | 23,679,297 |
| Goodwill | 1.2 | **12,376,524** | - |
| Advances to an associate and others | 20 | **17,712,002** | 186,958,884 |
| Assets held-for-sale | 12.6 | **4,937,186** | 5,338,900 |
| Prepaid expenses | | **2,897,492** | 6,627,422 |
| Other investment | 12.4 | **-** | 20,000,000 |
| Equity investment in an associate | 12.5 | **-** | 18,408,870 |
| Intangible assets - net | 12.3 | **-** | 5,250,128 |
| Others | | **14,093,831** | 9,486,402 |
| | | **139,372,644** | 398,551,283 |
| Allowance for impairment | | **( 15,126,946)** | ( 7,701,324) |
| | | **P 124,245,698** | P 390,849,959 |

### *12.1 Accounts Receivables*

The Accounts receivable is mainly composed of receivables from remittance companies arising from money remittance operations. In 2019, allowance amounting to P5.1 million has been recognized from the merger, as this amount pertains to accounts receivables recognized from the books of DAHBI.

### *12.2 Sales Contract Receivable*

Sales contract receivables represent the balance of the selling price of assets owned or acquired under an agreement, which were subsequently sold to buyers, wherein the title to the said assets shall only be transferred to the buyer upon full payment. Allowance for impairment losses as at December 31, 2019 and 2018 amounted to P2.0 million and P0.9 million, respectively.

### *12.3 Intangible Assets*

The Bank's intangible assets consist of the following:

*(a) Software*

Software mainly consists of payments for the right to use FinnOne, the comprehensive banking solution software used by the Bank. The movements in the carrying value of this account are shown below.

| | 2019 | 2018 |
|---|---|---|
| Balance at beginning of year | **P 3,084,356** | P 3,841,442 |
| Amortization during the year | **( 3,084,356)** | ( 757,086) |
| Balance at end of year | **P -** | P 3,084,356 |

The amortization on software is presented as part of Depreciation and amortization under Other Expenses account in the statements of comprehensive income (see Note 17.2).

*(b)* *License*

In December 2014, the Bank made a one-time, non-refundable membership fee to Philippine Clearing House Corporation (PCHC), which entitled the Bank to participate directly in the clearing operations of PCHC and BSP. The fee paid by the Bank amounts to P10.8 million and was amortized over five years beginning January 1, 2015. The movements in the carrying value of this account are shown below.

| | **2019** | 2018 |
|---|---|---|
| Balance at beginning of year | **P 2,165,772** | P 4,331,544 |
| Amortization during the year | **( 2,165,772)** | ( 2,165,772) |
| Balance at end of year | **P -** | P 2,165,772 |

The Bank's amortization is presented as part of Depreciation and amortization under Other Expenses account in the statements of comprehensive income (see Note 17.2).

### *12.4 Other Investment*

Other investment as of December 31, 2018 pertains to the Bank's investment in escrow fund with a certain bank to acquire certain non-listed equity shares. On June 6, 2017, the BSP approved the Bank's application for the acquisition of the non-listed equity shares. The escrow fund is yet to be released and the consideration paid for the acquisition of DAHBI from the Bank's unrestricted cash.

Upon approval of the BSP on June 6, 2017 of the Bank's application for the acquisition of the 20% ownership interest in SRBI, the Bank recognized the previous payments as an investment in an associate accounted for under the equity method.

### *12.5 Investment in an Associate*

The carrying value of investment in SRBI accounted for under the equity method as of December 31, 2018 (nil as of December 31, 2019) is as follows:

| | |
|---|---|
| Acquisition cost | P 4,379,086 |
| Excess of share of fair value of net assets over cost | 8,990,366 |
| Accumulated share in profit | 4,629,221 |
| Accumulated share in OCI | 410,197 |
| | **P 18,408,870** |

As of December 31, 2018, the Bank's share in net assets of SRBI amounted to P13.4 million resulting in an excess of share in fair value of net assets over cost amounting to P4.4 million included as part of Share in net profit of an associate under Other Income account in the 2018 statement of comprehensive income. Subsequently, it was derecognized as it formed part of the consideration of the merger that was approved by the SEC during the year.

| | Notes | 2019 | 2018 |
|---|---|---|---|
| Balance at beginning of year | | **P 18,408,870** | P 13,557,341 |
| Share in profit of associate | 17.1 | **5,583,558** | 4,441,331 |
| Share in OCI | | **( 572,586)** | 410,198 |
| Balance before merger | 1.2 | **23,419,842** | 18,408,870 |
| Gain on fair valuation of previously held interest | 1.2, 17.1 | **6,564,211** | - |
| Effect of merger | 1.2 | **( 29,984,053)** | - |
| Balance at end of year | 1.2 | **P -** | P 18,408,870 |

Summarized financial information as of December 31, 2018 with respect to the Bank's associate is presented below.

| | |
|---|---|
| Total resources | P 861,870,233 |
| Total liabilities | ( 758,773,614) |
| Net assets | P 103,096,619 |
| Total income | P 107,850,875 |
| Total expenses | ( 85,644,213) |
| Net profit for the year | 22,206,662 |
| Other comprehensive income | 2,050,986 |
| | 24,257,648 |
| Ownership interest | 20% |
| Share in total comprehensive income for the year | P 4,851,530 |

In addition, the Bank granted advances to SRBI totaling P51.4 million, which remains outstanding as of December 31, 2018. These advances are payable on demand, non-interest bearing and unsecured. As a result of the merger, this was subsequently eliminated from the Bank's books of accounts. A reconciliation of other investment balance is presented below.

| | 2019 | 2018 |
|---|---|---|
| Balance at beginning of year | **P 51,363,266** | P 40,000,000 |
| Advances during the year | **52,715,635** | 86,017,152 |
| Repayment during the year | **( 58,928,187)** | ( 74,653,886) |
| Effect of merger | **( 45,150,714)** | - |
| Balance at end of year | **P -** | P 51,363,266 |

### *12.6 Assets Held for Sale*

The Bank's assets held for sale is composed of the following:

| | 2019 | 2018 |
|---|---|---|
| Jewelry | P 4,111,712 | P 5,203,890 |
| Motor vehicle | 825,474 | 135,000 |
| | P 4,937,186 | P 5,338,890 |

The changes in the carrying amount of the assets held-for-sale are summarized as follows:

| | 2019 | 2018 |
|---|---|---|
| Balance at beginning of year | P 5,338,890 | P 4,264,628 |
| Effect of merger | 281,546 | - |
| Sale and redemption | ( 683,250) | ( 5,169,323) |
| Repossessions | - | 6,243,585 |
| Balance at end of year | P 4,937,186 | P 5,338,890 |

The fair values of the Bank's assets held-for-sale were based on the latest appraised values, as determined by internal professional appraisers (see Note 5.3.2).

Net gain on sale of assets held-for-sale amounted to P0.7 million and P2.1 million in 2019 and 2018, respectively and is included as part of Gain on sale of non-financial assets under the Other Income account in the statements of comprehensive income (see Note 17.1).

All of the Bank's other resources have been reviewed for indications of impairment. Certain accounts receivables were found to be impaired and provisions have been recorded accordingly. A reconciliation of allowance for impairment at the beginning and end of the reporting period is shown below.

| | Note | 2019 | 2018 |
|---|---|---|---|
| Balance at beginning of year | | P 7,701,324 | P 4,861,864 |
| Effect of merger | 1.2 | 5,065,580 | - |
| Impairment loss during the year | | 2,481,321 | 3,348,413 |
| Write-off | | ( 121,278) | ( 508,953 ) |
| Balance at end of year | | P 15,126,946 | P 7,701,324 |

Allowance for impairment of amounting to P12.0 million pertains to various non-financial assets lodged in this account. Impairment losses recognized in 2019 and 2018 are presented as part of Impairment Losses account in the statements of comprehensive income.

## 13. DEPOSIT LIABILITIES

Deposit liabilities are in the form of savings, demand and time deposits with annual interest rates ranging from 1.00% to 16.67% per annum both in 2019 and 2018. Interest expense on deposit liabilities in 2019 and 2018 amounting to P131.5 million and P134.3 million, respectively, is shown as Interest Expense on Deposit Liabilities in the statements of comprehensive income.

The breakdown of deposit liabilities are as follows:

| | **2019** | 2018 |
|---|---|---|
| Demand | **P 419,307,464** | P 386,270,967 |
| Savings | **2,419,485,228** | 1,591,677,346 |
| Time | **2,454,971,565** | 2,180,396,199 |
| | **P 5,293,764,257** | P 4,158,344,512 |

Under existing BSP regulations, deposit liabilities are subject to regular and liquidity reserve of 4.00% and 8.00% in 2019 and 2018, respectively. The Bank has reserves from its balance in Due from BSP account amounting to P291.9 million and P370.5 million as of December 31, 2019 and 2018, respectively (see Note 6.2). The Bank is in compliance with these BSP regulations as of the end of reporting periods.

The maturity profile of deposit liabilities is disclosed in Note 4.2 is also shown below.

| | **2019** | 2018 |
|---|---|---|
| Within one year | **P 4,102,395,927** | P 3,619,435,550 |
| More than one year | **1,191,368,330** | 538,908,962 |
| | **P 5,293,764,257** | P 4,158,344,512 |

## 14. BILLS PAYABLE

This account consists of borrowings from:

| | **2019** | 2018 |
|---|---|---|
| Land Bank of the Philippines | **P 1,851,118,181** | P2,336,424,902 |
| Small Business Corporation | **115,941,061** | - |
| PDIC | **89,999,434** | - |
| Development Bank of the Philippines | **24,999,375** | 124,996,875 |
| United Coconut Planters Bank - Savings | **3,482,028** | - |
| Quedan Corporation | **86,989** | 86,989 |
| | **P2,085,627,068** | P 2,461,508,766 |

Bills payable are subject to annual fixed interest rates ranging from 2.00% to 7.30% and from 4.00% to 7.80% in 2019 and 2018, respectively, and have maturities ranging from one to four years. Interest expense on bills payable in 2019 and 2018 amounting to P140.1 million and P96.8 million, respectively, is shown as Interest Expense on Bills Payable in the statements of comprehensive income.

Bills payable are collateralized by the assignment of certain loans amounting to P2.4 billion and P1.9 billion as of December 31, 2019 and 2018, respectively (see Note 8).

The maturity profile of bills payable is presented below.

| | **2019** | 2018 |
|---|---|---|
| Within one year | **P1,266,621,637** | P 1,386,075,329 |
| Beyond one year | **819,005,431** | 1,075,433,437 |
| | **P2,085,627,068** | P2,461,508,766 |

The movements in this account are presented below:

| | Note | **2019** | 2018 |
|---|---|---|---|
| Balance at beginning of year | | **P2,461,508,766** | P 808,892,308 |
| Effect of merger | 1.2 | **257,853,084** | - |
| Additions | | **1,838,729,366** | 2,413,916,530 |
| Settlements | | **( 2,472,464,148)** | ( 761,300,072) |
| Balance at end of year | | **P2,085,627,068** | P2,461,508,766 |

## 15. ACCRUED EXPENSES AND OTHER LIABILITIES

The composition of this account follows:

| | Note | **2019** | 2018 |
|---|---|---|---|
| Accrued interest | | **P 192,815,326** | P 206,340,210 |
| Accounts payable | | **177,405,550** | 185,641,925 |
| Accrued expenses | | **48,312,542** | 41,369,421 |
| Income tax payable | | **22,417,439** | 38,646,569 |
| Post-employment benefit obligation | 18.2 | **6,531,134** | 36,169,861 |
| Redeemable preferred shares | | **5,000,000** | - |
| Others | | **74,571** | - |
| | | **P 452,556,562** | P 508,167,986 |

Accounts payable consists mainly of deposits from borrowers for the payment of registration of mortgage documents and redemption of property or assets acquired, and of loan payments made by borrowers prior to due date.

Accrued expenses consist of leave credits of employees, salary differentials, utilities expense and rent.

Redeemable preferred shares are mandatorily redeemable on a specific date. However, upon the release of the merger approval by the BSP, redemption of such were also approved, subject to the conditions that the Bank shall cancel the stock certificates in the stock and transfer books and shall submit the payment/redemption of said preferred shares within five banking days after such redemption. As of December 31, 2019, the Bank has not yet redeemed such due to some considerations being negotiated with the third party.

## 16. CAPITAL FUNDS AND CAPITAL MANAGEMENT

### *16.1 Capital Stock*

As of December 31, 2019 and 2018, the Bank has 160,000,000 authorized common shares, 2,000,000 preferred shares A and 38,000,000 preferred shares B. All of these types of shares are with par value of P10 per share. There are no outstanding preferred shares as of December 31, 2019 and 2018.

As of December 31, 2018, the capital stock of the Bank consists of 76,646,508 issued and outstanding common shares with par value of P10 per share. In 2019, as a result of the merger, 3,231,711 shares were issued to the stockholders of SRBI. As of December 31, 2019 and 2018, the Bank has 89 and 33 stockholders, respectively, owning 100 or more common shares each of the Bank's capital stock.

### *16.2 Capital Management*

*(a) Regulatory Capital*

The Bank's lead regulator, BSP, sets and monitors capital requirements of the Bank.

In implementing current capital requirements, BSP requires the Bank to maintain a prescribed ratio of 10% of qualifying regulatory capital to total risk-weighted assets including market risk and operational risk.

Under the relevant provisions of the current BSP regulations, the regulatory capital is analyzed into two tiers.

Tier 1 Capital and Tier 2 Capital are defined as follows:

(i) Tier 1 Capital includes the following:
   a. paid-up common stock;
   b. surplus and surplus reserves; and,
   c. undivided profits (for domestic banks only),

   Subject to deductions for:
   a. treasury shares (if any);
   b. unrealized losses on underwritten listed equity securities purchased;
   c. unbooked valuation reserves, and other capital adjustments based on the latest BSP report of examination;
   d. outstanding unsecured credit accommodations, both direct and indirect, to Directors, Officers, Stockholders and Related Interests (DOSRI);
   e. goodwill; and,
   f. deferred tax asset.

(ii) Tier 2 Capital includes:
   a. dividends distributable (if any);
   b. appraisal increment reserve – bank premises if any, as authorized by the Monetary Board of the BSP;
   c. deposit for stock subscription on common stock; and,
   d. general loan loss provision, limited to a maximum of 1.0% of credit risk-weighted assets.

The Bank's regulatory capital position as of December 31, 2019 and 2018 (as reported to the BSP) are presented as follows (in thousands of Philippine Pesos):

| | 2019 | 2018 |
|---|---|---|
| Tier 1 Capital | P 2,083,233 | P 1,684,577 |
| Tier 2 Capital | 39,338 | 33,753 |
| Total regulatory qualifying capital | P 2,122,571 | P 1,718,330 |
| Total risk weighted assets | P 9,509,087 | P 7,658,921 |
| Capital ratios: | | |
| Total regulatory capital expressed as percentage of total risk-weighted assets | 22.32% | 22.44% |
| Total Tier 1 expressed as percentage of total risk-weighted assets | 21.91% | 21.99% |

The above capital ratios comply with the related BSP prescribed ratios.

*(b) Capital Allocation*

The allocation of capital between specific operations and activities is, to a large extent driven by optimization of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degrees of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocation of capital to specific operations and activities is undertaken independently of those responsible for the operation, and is subject to review by the Bank's RMC.

Although maximization of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account profitability is also taken, and synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the BOD.

*(c) Minimum Capital Requirement*

In 2014, the BSP issued Circular No. 854 increasing the minimum capitalization of banks. For thrift banks with head office outside national capital region with 11 to 50 branches, the minimum capitalization is P400.0 million, while for thrift banks with more than 50 branches, the minimum capitalization is P800.0 million

The Bank has complied with the above minimum capital requirement as of December 31, 2019 and 2018.

## 17. OTHER INCOME AND OPERATING EXPENSES

### *17.1 Other Income*

Presented below are the details of this account:

| | Notes | 2019 | 2018 |
|---|---|---|---|
| Service fees and charges | | **P 264,276,178** | P 303,805,922 |
| Recovery on charged-off assets | | **58,464,039** | 46,626,746 |
| Gain on reversal of impairment losses | | **44,261,462** | - |
| Gain on fair valuation of previously held interest | 1.2, 12.5 | **6,564,211** | - |
| Gain (loss) on sale of non-financial assets | 11, 12 | **5,718,301** | ( 3,575,015) |
| Share in net profit of an associate | 12 | **5,583,558** | 4,441,331 |
| Miscellaneous | | **56,359,262** | 64,469,549 |
| | | **P 441,227,011** | P 415,768,533 |

Miscellaneous income includes penalties charged to borrowers for late payments and minimal income by the Bank in the normal course of business.

### *17.2 Other Expenses*

Presented below are the details of these accounts:

| | Notes | 2019 | 2018 |
|---|---|---|---|
| Salaries and employee benefits | 18.1 | **P 249,527,109** | P 218,103,392 |
| Taxes and licenses | 25 | **122,611,157** | 121,426,982 |
| Depreciation and amortization | 9, 10, 11, 12 | **58,930,727** | 39,318,212 |
| Security, clerical, messengerial and janitorial services | | **44,518,291** | 38,450,680 |
| Insurance expense | | **26,939,731** | 31,126,306 |
| Incentive fees | | **18,665,783** | 14,872,033 |
| Litigation expenses | | **18,605,145** | 10,099,608 |
| Power, light and water | | **17,432,354** | 18,108,449 |
| Postage, telephone, cables and telegrams | | **16,751,866** | 16,430,935 |
| Repairs and maintenance | | **16,040,869** | 12,634,303 |
| Information technology services | | **13,115,611** | 21,547,429 |
| Fuel and lubricants | | **13,031,448** | 12,258,650 |
| Transportation and travel | | **12,142,158** | 10,107,388 |
| Supplies | | **11,503,136** | 12,759,189 |
| Management and professional fees | 20.1(b) | **9,716,617** | 6,634,229 |
| Advertising and publicity | | **4,387,800** | 1,888,521 |
| *Balance carried forward* | | **P 653,919,802** | P 585,766,306 |

| | Notes | 2019 | 2018 |
|---|---|---|---|
| *Balance brought forward* | | **P 653,919,802** | P 585,766,306 |
| Rent | 10.3, 21.1 | **3,927,442** | 20,206,849 |
| Banking fees | | **2,971,809** | 4,155,288 |
| Donations and charitable contributions | | **2,170,842** | 2,005,841 |
| Representation and entertainment | | **1,846,191** | 2,228,191 |
| Miscellaneous | | **27,962,141** | 30,706,613 |
| | | **P 692,798,227** | P 645,069,088 |

## 18. EMPLOYEE BENEFITS

### *18.1 Salaries and Employee Benefits Expense*

Expenses recognized for employee benefits are analyzed below.

| | Notes | 2019 | 2018 |
|---|---|---|---|
| Short-term employee benefits | | **P 241,068,073** | P 210,773,239 |
| Post-employment benefits | 18.2 | **8,459,036** | 7,330,153 |
| | 17.2 | **P 249,527,109** | P 218,103,392 |

### *18.2 Post-employment Benefits*

*(a) Characteristics of the Defined Benefit Plan*

The Bank maintains a funded, tax-qualified, non-contributory post-employment benefit plan that is being administered by a trustee bank that is legally separated from the Bank. The trustee bank managed the fund in coordination with the Bank's Retirement Plan Committee who acts in the best interest of the plan assets and is responsible for setting the investment policies. The post-employment plan covers all regular full-time employees.

The normal retirement age is 60 with a minimum of five years of credited service. The plan also provides for an early retirement at age 50 with a minimum of five years of credited service and late retirement after age 60, both subject to the approval of the Bank's BOD. Normal retirement benefit is an amount equivalent to 150% of the final monthly covered compensation (average monthly basic salary during the last 12 months of credited service) for every year of credited service.

*(b) Explanation of Amounts Presented in the Financial Statements*

Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions. All amounts presented below are based on the actuarial valuation report obtained from an independent actuary in 2019 and 2018.

The amount of post-employment benefit obligation recognized in the financial statements is determined as follows (see Note 15):

| | 2019 | 2018 |
|---|---|---|
| Present value of obligation | P 88,029,571 | P 73,309,206 |
| Fair value of plan assets | ( 81,498,437) | ( 37,139,345) |
| | P 6,531,134 | P 36,169,861 |

The movements in present value of the retirement benefit obligation recognized in the books are as follows:

| | 2019 | 2018 |
|---|---|---|
| Balance at beginning of year | P 73,309,206 | P 62,018,139 |
| Current service cost | 8,459,036 | 7,330,153 |
| Interest expense | 5,483,529 | 3,535,034 |
| Actuarial losses (gains) arising from: | | |
| Changes in financial assumptions | ( 3,354,901) | 13,086,478 |
| Experience adjustment | 742,924 | ( 8,870,043) |
| Effect of merger | 13,500,417 | - |
| Benefits paid directly from book reserves | ( 10,110,640) | ( 3,790,555) |
| Balance at end of year | P 88,029,571 | P 73,309,206 |

The movements in the fair value of plan assets are presented below.

| | 2019 | 2018 |
|---|---|---|
| Balance at beginning of year | P 37,139,345 | P 37,376,872 |
| Investment properties reclassified to plan assets | 29,800,377 | - |
| Return on plan assets (excluding amounts included in net interest) | 441,228 | ( 2,368,009) |
| Effect of merger | 11,339,464 | - |
| Interest income | 2,778,023 | 2,130,482 |
| Balance at end of year | P 81,498,437 | P 37,139,345 |

Actual return on plan assets resulted to a gain amounted to P3.2 million in 2019 and a loss amounted to P0.2 million in 2018.

The composition of the fair value of plan assets at the end of the reporting period by category and risk characteristics is shown below.

| | 2019 | 2018 |
|---|---|---|
| Government and corporate bonds | P 35,765,189 | P 35,427,124 |
| Debt Instruments – Other Bonds | 460,528 | - |
| Cash and cash equivalents | 25,998 | 2,045,994 |
| Others | 887,630 | - |
| Liabilities | - | ( 96,246) |
| | 37,139,345 | 37,376,872 |
| Investment properties reclassified to plan assets | 29,800,377 | - |
| Effect of merger | 11,339,464 | - |
| Actual returns on plan assets | 3,219,251 | ( 237,527) |
| | P 81,498,437 | P 37,139,345 |

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

The fair value of the plan assets is at Level 1 in the fair value hierarchy except for investment properties which are at Level 2, loans and other receivables and other properties, which are at Level 3.

The components of amounts recognized in profit or loss and in other comprehensive income in respect of the defined benefit obligation are presented below.

| | 2019 | 2018 |
|---|---|---|
| *Recognized in profit or loss:* | | |
| Current service cost | P 8,459,036 | P 7,330,153 |
| Net interest expense | 2,705,506 | 1,404,552 |
| | P 11,164,542 | P 8,734,705 |
| *Recognized in other comprehensive income (loss):* | | |
| Actuarial losses (gains) arising from changes in: | | |
| financial assumptions | (P 3,354,901) | P 13,086,478 |
| experience adjustments | 742,924 | ( 8,870,043) |
| Effect of merger | 817,981 | - |
| Return on plan assets (excluding amounts included in net interest expense) | ( 441,228) | 2,368,009 |
| | (P 2,235,224) | P 6,584,444 |

Current service cost is presented as part of Salaries and employee benefits under the Other Expenses account (see Note 17.2) while net interest expense is included as part of the Other interest expenses under Interest Expense account in the statements of comprehensive income.

Amounts recognized in other comprehensive income were included within the item that will not be reclassified subsequently to profit or loss.

In determining the amounts of post-employment benefit obligation, the following significant actuarial assumptions were used:

| | **2019** | 2018 |
|---|---|---|
| Discount rates | **5.16%** | 7.48% |
| Expected rate of salary increases | **4.00%** | 7.00% |

Assumptions regarding future mortality experience are based on published statistics and mortality tables. The average remaining working lives of an individual retiring at the age of 60 is 28 years. These assumptions were developed by management with the assistance of an independent actuary. Discount factors are determined close to the end of each reporting period by reference to the interest rates of zero coupon government bonds with terms of maturity approximating to the terms of the retirement obligation. Other assumptions are based on current actuarial benchmarks and management's historical experience.

(c) *Risks Associated with the Retirement Plan*

The plan exposes the Bank to actuarial risks such as investment risk, interest rate risk, longevity risk and salary risk.

*(i) Investment and Interest Risks*

The present value of the defined benefit obligation is calculated using a discount rate determined by reference to market yields of government bonds. Generally, a decrease in the interest rate of reference government bonds will increase the plan obligation. However, this will be partially offset by an increase in the return on the plan's investments in debt securities and if the return on plan asset falls below this rate, it will create a deficit in the plan. Currently, the plan has cash and cash equivalents, debt securities and investment properties. Due to the long-term nature of the plan obligation, a level of continuing debt securities is an appropriate element of the Bank's long-term strategy to manage the plan efficiently.

*(ii) Longevity and Salary Risks*

The present value of the defined benefit obligation is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment and to their future salaries. Consequently, increases in the life expectancy and salary of the plan participants will result in an increase in the plan obligation.

(d) *Other Information*

The information on the sensitivity analysis for certain significant actuarial assumptions, asset-liability matching strategy, and the timing and uncertainty of future cash flows related to the retirement plan are described in the succeeding page.

*(i) Sensitivity Analysis*

Each sensitivity analysis on the significant actuarial assumptions was prepared by remeasuring the defined benefit obligation at the actuarial valuation report date after first adjusting one of the current assumptions according to the applicable sensitivity increment or decrement, based on changes in the relevant assumption that were reasonably possible at the valuation date, while all other assumptions remained unchanged. The sensitivities were expressed as the corresponding change in the defined benefit obligation.

The following table summarizes the effects of changes in the significant actuarial assumptions used in the determination of the defined benefit obligation as of December 31:

| | | Impact on Post-Employment Benefit Obligation | |
|---|---|---|---|
| | Change in Assumption | Increase in Assumption | Decrease in Assumption |
| **2019:** | | | |
| Discount rate | **+/- 1.00%** | **P 4,928,556** | **(P 4,383,370)** |
| Salary growth rate | **+/- 1.00%** | **4,936,530** | **4,470,019** |
| 2018: | | | |
| Discount rate | +/- 1.00% | (P 4,749,995) | P 4,226,752 |
| Salary growth rate | +/- 1.00% | 4,749,995 | ( 4,282,414) |

The sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions, the same method (present value of the defined benefit obligation calculated with the projected unit credit method at end of the reporting period) has been applied as when calculating the pension liability recognized within the statements of financial position.

*(ii) Funding Arrangements and Expected Contributions*

The schedule of expected future benefit payments as of December 31 for the next ten years is as follows:

| | **2019** | 2018 |
|---|---|---|
| Within one year | **P 26,821,901** | P 25,849,871 |
| Beyond one year but less than five years | **19,008,535** | 19,626,568 |
| Beyond five years | **49,943,157** | 56,078,431 |
| | **P 95,773,593** | P 101,554,870 |

The weighted average duration of the defined benefit obligation at the end of the reporting period is 6.1 years. The Bank expects to contribute P15.0 million to the plan in 2019.

## 19. TAXES

The components of tax expense as reported in the statements of comprehensive income for the years ended December 31, 2019 and 2018 are as follows:

| | 2019 | 2018 |
|---|---|---|
| *Recognized in profit or loss* | | |
| Current tax expense: | | |
| Regular corporate income tax at 30% (RCIT) | **P 83,127,081** | P 103,827,379 |
| Final tax at 20% | **5,833,407** | 3,644,679 |
| | **88,960,488** | 107,472,058 |
| Deferred tax income (expense) relating to origination and reversal of temporary differences | **72,734,841** | ( 8,278,235) |
| | **P 161,695,329** | P 99,193,823 |
| *Recognized in other comprehensive income* | | |
| Deferred tax income (expense) relating to origination and relating to temporary differences | **(P 670,567)** | P 1,799,534 |

The reconciliation of tax on pretax profit computed at the applicable statutory rates to tax expense related in profit or loss section is shown below.

| | 2019 | 2018 |
|---|---|---|
| Tax on pretax profit at 30% | **P 161,019,030** | P 104,574,646 |
| Adjustment for income subjected to lower income tax rates | **( 2,916,703)** | ( 1,822,340) |
| Tax effects of non-deductible expenses and non-taxable income | **5,562,265** | ( 3,558,483) |
| Non-taxable income | **( 1,969,263)** | - |
| | **P 161,695,329** | P 99,193,823 |

The deferred tax assets (presented under Other Resources account in the statements of financial position – see Note 12) as of December 31 relate to the following:

| | Statements of Financial Position | | Statements of Comprehensive Income | | | |
|---|---|---|---|---|---|---|
| | | | Profit or Loss | | Other Comprehensive Income | |
| | 2019 | 2018 (As Restated) | 2019 | 2018 (As Restated) | 2019 | 2018 |
| Deferred tax assets: | | | | | | |
| Allowance for impairment: | | | | | | |
| Loans and discount | **P 20,907,853** | P 74,656,268 | **P 58,690,586** | (P 6,451,606) | **P -** | P - |
| Investment properties | **39,232** | - | **-** | - | **-** | - |
| Other resources | **3,018,410** | 2,310,397 | **( 708,013)** | ( 851,837) | **-** | - |
| Accumulated depreciation – investment property | **405,657** | 1,862,165 | **1,456,508** | 508,453 | | |
| Post-employment benefit obligation | **1,486,853** | 10,850,958 | **12,243,334** | ( 1,483,245) | **( 670,567)** | 1,799,534 |
| Lease liabilities | **45,878,508** | - | **( 43,578,243)** | - | | |
| Unamortized past service cost | **2,748,087** | 5,470,673 | **2,722,586** | - | **-** | - |
| Deferred tax liability – Right-of-use assets | **( 43,965,768)** | - | **41,908,083** | - | **-** | - |
| Deferred tax assets – net | **P 30,518,832** | P 95,150,461 | | | | |
| Deferred tax income (expense) – net | | | **P 72,734,841** | (P 8,278,235) | **(P 670,567)** | P 1,799,534 |

The Bank is subject to minimum corporate income tax (MCIT), which is computed at 2% of the Bank's gross income as defined under the tax regulations or to RCIT, whichever is higher. No MCIT was reported in 2019 and 2018 as the RCIT was higher than MCIT in those years.

In 2019 and 2018, the Bank opted to claim itemized deductions in computing of its income tax due.

## 20. RELATED PARTY TRANSACTIONS

The Bank's related parties include its DOSRI, related parties under common ownership, the Bank's key management personnel and others as described below.

The summary of the Bank's significant transactions and outstanding balance with its related parties as of and for the years ended December 31, 2019 and 2018 are as follows:

| Related Party Category | Notes | 2019 Amount of Transaction | 2019 Outstanding Balance | 2018 Amount of Transaction | 2018 Outstanding Balance |
|---|---|---|---|---|---|
| **Common ownership** | | | | | |
| Advances | 12 | **P -** | **P -** | P 40,300,000 | P 40,300,000 |
| **DOSRI** | | | | | |
| Deposits | 20.1(a) | **148,747,585** | **31,368,179** | 123,378,409 | 36,832,978 |
| Loan receivables | 20.1(a) | **31,483,242** | **36,070,641** | 1,851,018 | 5,040,437 |
| Advances | | **6,441,492** | **44,921,774** | - | - |
| Management fees | 20.1(b) | **572,096** | **-** | 1,217,216 | - |
| **Associate** | | | | | |
| Advances | 12 | **101,737,110** | **44,921,774** | 106,658,884 | 146,658,884 |
| **Key management personnel** | | | | | |
| Compensation | 18.2 | **30,492,200** | **-** | 26,293,752 | - |

### *20.1 DOSRI*

*(a) Loans and Deposits*

Current banking regulations limit the amount of individual loans to DOSRI, of which 70.00% must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Bank. In the aggregate, loans to DOSRI generally should not exceed the total equity or 15.00% of the total loan portfolio of the Bank, whichever is lower.

*(b) Management Services*

In 2014, the Bank entered into a management service contract with the regional operating headquarters (ROHQ) of Bridge, where Bridge is a stockholder of the Bank. The service contract to be rendered by Bridge ROHQ covers the following projects:

- Implementation of action plan from corporate governance review;
- Design of incentive system based linking reward to performance;
- Dissemination of current best practice sales approaches techniques;

- Identification of behavioral indicators of future loan repayment and re-design renewal credit assessment;

- Reduction of collection frequency and elimination of unproductive account officer activities;

- Design and automation of collection process; and,

- Review of market, segment, client needs, competition, and alternative additional products.

The Bank recognized management fees expense amounting to P0.6 million and P1.2 million in 2019 and 2018, respectively, for the services billed by Bridge ROHQ reported as part of Management and professional fees under Other Expenses account in the statements of comprehensive income. There is no outstanding liability arising from this transaction as of December 31, 2019 and 2018.

### *20.2 Key Management Compensation*

The compensation of key management personnel is broken down as follows:

| | **2019** | 2018 |
|---|---|---|
| Short-term employee benefits | **P 30,276,531** | P 19,184,029 |
| Post-employment defined benefit | **215,669** | 7,109,723 |
| | **P 30,492,200** | P 26,293,752 |

### *20.3 Retirement Plan*

The Bank's retirement fund is a multi-employer retirement plan, which is administered by a trustee bank. The retirement fund includes investments in government bonds and cash and cash equivalents with fair value totalling P81.5 million and P37.1 million as of December 31, 2019 and 2018, respectively. The retirement fund has no outstanding deposits or investment in the Bank as of December 31, 2019 and 2018.

The details of the contributions of the Bank and benefits paid out by the plan to employees are presented in Note 18.2(b).

## 21. COMMITMENTS AND CONTINGENCIES

The following are the significant commitments and contingencies involving the Bank:

### *21.1 Operating Lease Commitments*

The Bank entered into non-cancellable lease agreements for the lease of its office spaces and the premises where some of its branches and extension offices are situated for a period of three to eight years, renewable upon mutual agreement between the parties. These leases are accounted for as operating leases which either require fixed rental rate over the term of the lease or with stipulated annual escalation rate of 5.00% to 10.00%.

The future minimum rentals payable under these operating leases as of December 31, 2018 are as follows:

| | | |
|---|---|---|
| Within one year | P | 17,103,282 |
| Beyond one year but less than five years | | 16,391,656 |
| Beyond five years | | 78,911,414 |
| | P | 112,406,352 |

Total rent expense related to these operating leases amounted to P20.2 million in 2018, and is presented as Rent under Other Expenses account in the 2018 statement of comprehensive income (see Note 17.2).

### *21.2 Others*

The Bank is a plaintiff in various cases pending in courts for alleged claims against the Bank, the outcome of which are not fully determinable as of date. Also, in the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities, which are not reflected in the financial statements. The Bank recognizes in its books any losses and liabilities incurred in the course of its operations as soon as these become determinable and quantifiable. Management believes that, as of December 31, 2019 and 2018, no additional material losses or liabilities are required to be recognized in the financial statements as a result of these commitments and transactions.

## 22. EVENTS AFTER THE END OF THE REPORTING PERIOD

### *22.1 Dividend Declaration*

On February 8, 2020, the Bank's BOD approved the declaration of cash dividends amounting to P100 million and stock dividend amounting to P233.5 million (23,353,492 shares) in favor of all stockholders on record as of December 31, 2019 and payable on February 28, 2020.

### *22.2 Impact of Coronavirus*

In December 2019, a novel strain of coronavirus (COVID-19) was reported to have surfaced in China. The World Health Organization has declared the outbreak as a 'public health emergency of international concern.' COVID-19 started to become widespread in the Philippines in early March 2020 causing the government to declare the country in a state of public health emergency followed by implementation of enhanced community quarantine and social distancing measures and restrictions within the Luzon area with other cities and provinces in the country enacting similar measures thereafter. This resulted in a wide-ranging business suspension – disrupting the supply chains, affecting production and sales across a range of industries, and weakening the stock market.

In support and compliance with the government measures to protect the welfare and interest of the Bank's employees and stakeholders, including its counterparties, the Bank has implemented safety measures and activated its business continuity procedures. The Bank continued to provide access to cash, providing sufficient liquidity in the banking system, and managing stable payments and settlements. Management believes that these measures can mitigate the further negative impact of the outbreak to the Bank's business and to its financial condition and performance.

While the disruption is currently expected to be temporary, management expects the suspension of businesses to negatively impact the Bank's financial condition and results of operations. However, the severity of these consequences will depend on certain developments, including the duration and spread of the outbreak, impact on Bank's customers, employees, and the accessibility and effectiveness of government support programs, all of which are uncertain and cannot be predicted as of the date of the issuance of the Bank's financial statements. Accordingly, management is not able to reliably estimate the impact of the outbreak on the Bank's financial position and results of operation for future periods.

The Bank has determined that these events are non-adjusting subsequent events. Accordingly, their impact was not reflected in the Bank's financial statement as of and for the year ended December 31, 2019.

## 23. OTHER INFORMATION REQUIRED BY THE SECURITIES AND EXCHANGE COMMISSION

R.A. No. 11232, *An Act Providing for the Revised Corporation Code of the Philippines* (the Revised Corporation Code) took effect on March 8, 2019. The new provisions of the Revised Corporation Code or any amendments thereof have no significant impact to the Bank's financial statements.

## 24. SUPPLEMENTARY INFORMATION REQUIRED BY THE BANGKO SENTRAL NG PILIPINAS

Presented below are the supplementary information required by the BSP under Section 174 (Appendix 55) of the BSP MORB to be disclosed as part of the notes to financial statements.

*(a) Selected Financial Performance Indicators*

| | **2019** | 2018 |
|---|---|---|
| Earnings on average equity | **17.14%** | 13.73% |
| Earnings on average resources | **3.85%** | 3.07% |
| Net interest margin | **9.21%** | 9.84% |

*(b) Capital Instruments Issued*

The Bank is authorized to issue common and preference shares but the capital instrument issued by the Bank comprise only of common shares (CET 1). As of December 31, 2019 and 2018, there are 76,646,508 and 79,878,219 common shares, respectively, which were issued and outstanding.

*(c) Significant Credit Exposures for Loans*

An analysis of concentration by industry or economic sector of loans and receivables (grossed up for any allowance for impairment losses) of the Bank, as of December 31, 2019 and 2018 are shown below.

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Amount** | **Percentage** | Amount | Percentage |
| Other community, social and personal activities | **P 4,437,424,887** | **55.00%** | P4,002,375,567 | 57.56% |
| Agriculture, hunting and forestry | **1,314,725,966** | **16.30%** | 1,555,793,718 | 22.56% |
| Wholesale, retail trade, household and consumption | **2,033,939,462** | **25.21%** | 1,382,183,346 | 19.88% |
| Real estate, renting and business activities | **281,927,556** | **3.49%** | - | 0.00% |
| | **P 8,068,017,871** | **100.00%** | P6,940,352,631 | 100.00% |

The BSP considers that concentration of credit exists when total loan exposure to a particular industry or a particular economic sector exceeds 30.00% of total loan portfolio. Management believes that the Bank's credit concentration in other community, social and personal activities as at December 31, 2019 and 2018, respectively, are justifiable considering that it is consistent with the nature of its operation as a rural bank, whose primary purpose is meeting the normal credit needs general community and cooperative.

*(d) Credit Status of Loans*

| | 2019 | | |
|---|---|---|---|
| | **Performing** | **Non-performing** | **Total Loan Portfolio** |
| Gross carrying amount: | P 7,571,696,060 | P 530,042,998 | P 8,101,739,058 |
| Allowance for ECL | ( 111,450,356) | ( 126,506,666) | ( 237,957,022) |
| **Net carrying amount** | **P 7,460,245,704** | **P 403,536,332** | **P 7,863,782,036** |

| | 2018 | | |
|---|---|---|---|
| | Performing | Non-performing | Total Loan Portfolio |
| Gross carrying amount: | P 6,419,335,472 | P 545,183,712 | P 6,964,519,184 |
| Allowance for ECL | ( 73,919,472) | ( 174,934,753) | ( 248,854,225) |
| Net carrying amount | P 6,345,416,000 | P 370,248,959 | P 6,715,664,959 |

*(e) Information on Related Party Loans*

In the ordinary course of business, the outstanding loans, deposits and other transactions with DOSRIs are shown in Note 20.1. Under the current BSP regulations, the amount of individual loans to a DOSRI, 70% of which must be secured, should not exceed the amount of the encumbered deposit. In the aggregate, loans to DOSRIs, generally, should not exceed the total equity or 15% of the total loan portfolio of the Bank. However, non-risk loans are excluded in both individual and aggregate ceiling computation.

| | DOSRI Loans | | Related Party Loans (inclusive of DOSRI) | |
|---|---|---|---|---|
| | **2019** | 2018 | **2019** | 2018 |
| Total outstanding loans | **P 36,070,641** | P 5,040,437 | **P 36,070,641** | P 5,040,437 |
| % of loans to total loan portfolio | **0.45%** | 0.07% | **0.45%** | 0.07% |
| % of unsecured loans to total DOSRI/related party loans | **0.38%** | 10.72% | **0.38%** | 10.72% |
| % of past due loans to total DOSRI/related party loans | **0.00%** | 0.00% | **0.00%** | 0.00% |
| % of non-performing loans to total DOSRI/ related party loans | **0.00%** | 0.00% | **0.00%** | 0.00% |

As at December 31, 2019 and 2018, the Bank does not have loans, other credit accommodations and guarantees granted to DOSRI in accordance with BSP reporting guidelines.

*(f) Analysis of Loan Portfolio as to Type of Security*

The breakdown of total loans and receivables as to security with corresponding collateral types, and unsecured loans follows:

| | Note | **2019** | 2018 |
|---|---|---|---|
| Secured: | | | |
| Real estate mortgage | | **P 2,533,221,039** | P 1,610,039,758 |
| Deposits hold-out | 8 | **64,930,404** | 5,450,363 |
| Chattel mortgage | | **683,510,173** | 427,620,654 |
| | | **3,281,661,616** | 2,043,110,775 |
| Unsecured | | **4,820,077,442** | 4,921,408,409 |
| | | **P 8,101,739,058** | P 6,964,519,184 |

*(g) Secured Liabilities and Assets Pledged as Security*

Assets pledged by the Bank as security for liabilities are shown below.

| | **2019** | 2018 |
|---|---|---|
| Aggregate amount of secured liabilities | **P2,150,557,472** | P1,885,405,335 |
| Aggregate amount of resources pledged as security | **P2,150,557,472** | P1,885,405,335 |

*(b) Contingencies and Commitments Arising from Off-balance Sheet Items*

The Bank has no commitments and contingent accounts arising from transactions not given recognition in the statements of financial position, expressed at their equivalent peso contractual amounts as of the end of reporting period.

## 25. SUPPLEMENTAL INFORMATION REQUIRED BY THE BUREAU OF INTERNAL REVENUE

Following is the supplementary information on taxes, duties and license fees paid or accrued during the taxable year expressed in absolute amounts, which is required by the Bureau of Internal Revenue (BIR) under Revenue Regulation No. 15-2010, to be disclosed as part of the notes to financial statements. This supplementary information is not a required disclosure under PFRS.

*(a) Gross Receipts Tax*

In lieu of the value-added tax, the Bank is subject to gross receipt tax (GRT) imposed on all banks and non-bank financial intermediaries pursuant to Section 121 of the National Internal Revenue Code.

In 2019, the Bank reported total GRT amounting to P80,704,271, which is shown as part of Taxes and licenses under Operating Expenses account in the 2019 statement of comprehensive income (see Note 17.2).

*(b) Documentary Stamp Tax*

In general, the Bank's documentary stamp tax (DST) transactions arise from the execution of debt instruments, security documents, certificates of deposits and bills of exchange.

For the year ended December 31, 2019, DST affixed amounted to P26,078,250 representing documentary stamps imposed mainly on debt instruments documents issued during the period.

*(c) Taxes on Importations*

The Bank has not paid or accrued any taxes on importations as it has no importations for the year ended December 31, 2019.

*(d) Excise Tax*

The Bank did not have any transactions in 2019, which are subject to excise tax.

*(e) Taxes and Licenses*

The details of taxes and licenses in 2019 of the Bank are as follows:

| | Note | |
|---|---|---|
| GRT | | P 80,704,271 |
| DST | | 26,078,250 |
| Business permits and registration | | 12,219,116 |
| Others | | 3,609,520 |
| | 17.2 | **P 122,611,157** |

Taxes and licenses are presented under Operating Expenses in the 2019 statement of comprehensive income.

*(f) Withholding Taxes*

The details of total withholding taxes for the year ended December 31, 2019 are shown below.

| | |
|---|---|
| Final | P 20,072,990 |
| Compensation and employee benefits | 4,218,825 |
| Expanded | 4,617,670 |
| | **P 28,909,485** |

*(g) Deficiency Tax Assessments and Tax Cases*

As of December 31, 2019, the Bank does not have any final deficiency tax assessments from the BIR nor does it have tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open taxable years.




# ACKNOWLEDGEMENT

Our 2019 annual report is the result of the hard work and contribution of all members of the 1st Valley Bank family. We would like to especially acknowledge the working group who conceptualized, deliberated, reviewed, and designed this report: Nicolette Lim-Gica, Jubal Y. Yu, Romulo P. Fiel, Benjie Tadeo M. Abad, Jr., Alfredo F. Girbes, Anavic A. Sarsale, Felizardo A. Enad, Anderson Undag, Errol C. Dioso, Emily E. Enad, Ronnil Benales, Andre M. Ates, Annie Lisa G. Estrera, Jan Rhosidy G. Villa, Darlene Joy Dagondon, Norman F. Florida, Michael C. Cimafranca, Ernie S. Valenzuela, and Genevieve D. Valencia. Layout is by Kris P. Valdez.

1st Valley Bank
A Development Bank


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