SouthBank

Your Rural Bank

SOUTH BANK (A RURAL BANK), INC.

ANNUAL REPORT 2018

SouthBank

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The Bank's Vision

"As a leading countryside banking institution; the bank serves as catalyst for providing quality financial products and services to its clientele; an effective agent of financial inclusion even as it provides an environment to its employees to grow while ensuring maximum return on investments to its stockholders."

Mission

1. Establish additional branches and other banking units as indicated in the Bank's Five (5)-Year Strategic Plan, in order to further expand our reach.

2. Continue development of policy and procedures manuals to further improve our operations.

3. Develop loan and other products that are accessible to the unserved and underserved sectors of the society and to be an effective agent of inclusivity in the countryside.

4. Ensure full compliance with BSP, PDIC and other regulators' requirements and audit findings.

About the Bank

South Bank (A Rural Bank), Inc. was originally organized by a group of Cagayan de Oro businessmen in 1993 as Kagay-anon Rural Bank (Cagayan de Oro) Inc., and the only rural banking institution in Cagayan de Oro City at that time when establishment of bank branches was not yet liberalized.

Sometime in 1999, the Bank was acquired by the A Brown Group of Companies, the foremost real estate developer/owner of Xavier Estates and other real estate developments. Said conglomerate is led by Dr. Walter B. Brown, a noted businessman who is also in power, mining, and other businesses. It was then a single-branch banking unit, and was renamed South Bank, Inc.

In 2004, the Bank was acquired by the Zealep Group of Companies led by Dr. Rafaelita P. Pelaez, and has since grown from one (1) single branch rural bank to seven (7) branches and a fully-organized Head Office.

South Bank offers an array of products and services to the public, including Lending, Deposit Taking and Other Services like G-Cash, Bills Payment and Point of Sale Transactions (POS).

South Bank is a member of the Zealep Group owned by the Pelaez family, the core business of which is education (Liceo de Cagayan University and American International Education, Inc.), real estate, and finance, among others.

There are nine (9) members of the Board, headed by Dra. Rafaelita P. Pelaez as Chairman and Mr. Wilhelmino R. Mendoza as President and CEO. The Board has appointed two (2) Independent Directors and there are five (5) non-Zealep related Board Members who compose the RPT Committee.

The President and CEO, Wilhelmino R. Mendoza, formerly First Vice President and Area Head of BDO, Region Head of Solidbank and Land Bank of the Philippines, is noted for his professionalism, integrity, probity and individual advocacies.

Financial Highlights:

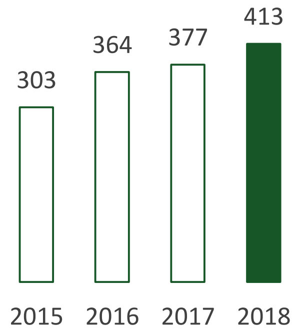
A Snapshot of the Bank's Performance

	SOLO		
Minimum Required Data	2018	2017	Change
Profitability			
Total Net Interest Income	Php 37,761,893	Php 40,098,674	-6%
Total Non-Interest Income	17,963,459	17,360,596	3%
Total Non-Interest Expenses	45,400,769	37,835,296	20%
Pre-Provision Profit	10,324,583	19,623,974	-47%
Allowance for Credit Losses	2,712,830	12,822,027	-79%
Net Income	7,611,753	6,801,947	12%
Selected Balance Sheet Data			
Liquid Assets[1/]	66,516,502	66,596,590	0%
Gross Loans	345,577,555	307,888,838	12%
Total Assets	412,659,302	376,832,627	10%
Deposit Liabilities	234,320,737	249,090,956	-6%
Total Equity	69,720,236	61,631,243	13%
Selected Ratios			
Return on Equity	11%	13%	
Return on Assets	2%	1%	
Capital Adequacy Ratio	14.88%	14.44%	
Others			
Cash Dividends Declared	None	None	
Headcount	80	71	
Officers	20	16	
Staff	60	55	

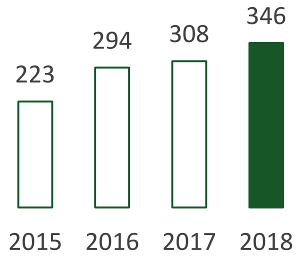
1/-Cash on Hand, Due from BSP, Due from Other Banks

Historical Trends & Figures

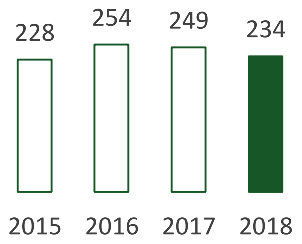
Resources



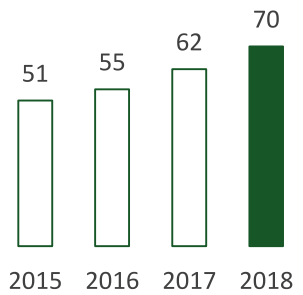
Gross Loan Portfolio



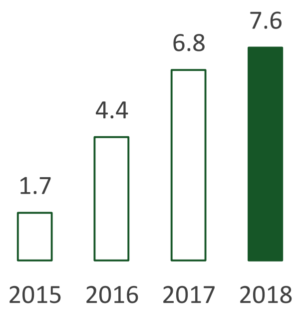
Deposit Liabilities



Capital Funds



Net Income



(In million Php)

Message from the President and CEO

Dear Stockholders and Friends,

In behalf of the Board of Directors of the Bank, led by our Chairman, Dr. Rafaelita P. Pelaez, and the officers and staff of Management, we are delighted to share with you the results of operation of our Bank in the year 2018.

Based on our 2018 Audited Financial Statements, the Bank's total assets at year-end 2018 which stood at P 412.6 M was P 35.8 M or 9.51% higher than 2017 balance of P 376.8 M. This was mainly due to the hefty increase in the Bank's Gross Loan Portfolio which grew by P 37.6 M or 12.24% from a 2017 level of P307.8 M to P 345.5 M in 2018.

Total liabilities also increased by P 27.7 M or 8.80% from P 315.2 M in 2017 to P 342.9 M in 2018.

Stockholders' equity improved by 13.12% or P 8.08 M at P 69.7 M in 2018 from P 61.6 M in 2017.

Net income was encouraging at P 7.6 M; some 11.76% over last year's P 6.8 M.

This year we continued to push our consumer loans, particularly the ATM-secured loans to PNP personnel, Public School Teachers and Pensioners. These consumption loan products are very viable offerings, taking from the experience of some of our peer banks whose main revenue drivers are these loan assets.

We continued the comprehensive review of the performance of all the other loan products to determine their viability and adaptability in our branches. We also considered, of course, their potential long term, sustainable and profitable performance. The performance of crop loan products, however, was quite weak due to the inconsistencies of weather conditions.

We continued to further strengthen the structural and operational framework of the Bank in keeping with the directives of the regulators, particularly in identifying risks and mitigating them. Chief among these risks are credit, operational and liquidity risks. We have endeavored to rise up to these challenges and worked hard to comply with the requirements of the regulators.

Our core banking system, the CBS, has already successfully implemented the Loans and GL System and will soon include CASA. The BSP examiners have evaluated the CBS and were impressed by it.

It was also worth mentioning that our intensified Loan Collection Program has continuously bear very satisfactory results. Face to face negotiation, selective waiver of portion of penalties and filing of cases at the Small Claims Court prove to be quite effective. Although not in a very dramatic pace, these efforts, as well as the more prudent selection of borrowers, have contributed to the decrease in past due rate.

We have started crafting new deposit products to give impetus to our deposit generation drives, and will soon embark on a more extensive deposit solicitation outside bank premises. We have planned to engage in opening low-denominated savings accounts under the Basic Deposit Framework approved by BSP so that we will be a more effective agent of financial inclusion.

Our recommendation for the increase in the capital stock of the Bank to P 150 M is under review by BSP. When approved, this will pave the way for the documentation of our proposed merger with the Rural Bank of Roxas in Oriental Mindoro.

We ended 2018, with profuse thanks and gratitude to our hardworking Board and Senior Management of the Bank, but most particularly to the support of our Chairman and our Stockholders.

Thank you again for your support.

Wilhelmino R. Mendoza
President and CEO

Risk Management

Overall Risk Management Culture and Philosophy

The Bank's risk management framework seeks to ensure that there is an effective process in place to manage risk across the Bank. Risk management is integral to all aspects of the Bank's activities and is the responsibility of all staff. Managers have a particular responsibility to evaluate their risk environment, to put in place appropriate controls and to monitor the effectiveness of those controls. The risk management culture emphasizes careful analysis and management of risk in all business processes.

Risk Appetite and Strategy

South Bank gives emphasis to the seven (7) categories identified to where risk is being weighted. The Bank acts in accordance to this risk statement to where our policy formulation and decision making strategy are anchored to ensure transparency and effective implementation of a sound Banking practice. The Bank has a low appetite for strategic, operational, reputation, and technological risk; and medium appetite for credit, financial risk, and human capital risk. Where we have discretion, the Bank is willing to assume more risk to be able to meet the challenges of an evolving market landscape. The best risk management practices will not prevent challenges but will enable the Bank to operate proactively.

The Bank's strategic objectives closely align with its mission, vision, and core values that adhere to best practices of a sound Banking institution. The Bank maintains a highly motivated, diverse, talented, and empowered work force and deploys resources to maximize their use and effectiveness. The Bank operates with integrity, maintains strong ethical standards, and adheres to applicable legal and regulatory requirements.

ERM Risk Appetite by Risk Category

Risk Category	Risk Appetite
Strategic	Low
Operation	Low
Credit	Moderate
Financial	Moderate
Reputation	Low
Technology	Low
Human Capital	Moderate

Risk Governance Structure and Risk Management Process

Risk management at South Bank begins at the highest level of the organization. At the helm of the risk management infrastructure is the Board of Directors who is responsible for establishing and maintaining a sound risk management system. The Board of Directors assumes oversight over the entire risk management process and has the ultimate responsibility for all risks taken. It regularly reviews and approves the institution's tolerance for risks, as well as, its business strategy and risk philosophy.

The Bank operates an enterprise-wide risk management framework to address the risks it faces in its banking activities. These risks are identified, assessed and managed at both an enterprise level ('top-down') and business level ('bottom-up'). Part of the framework, is to establish a Risk Appetite Statement that articulates the level and type of risk the Bank will accept while conducting its mission. This statement is the result of a careful evaluation of how risks affect the Bank's ability to achieve its strategic goals. Reporting systems are maintained to provide assurance that the risk appetite is effectively incorporated into management decisions.

Anti-Money Laundering (AML) and Terrorist Financing (TF)

The Bank is committed to uphold the highest standard of integrity and reputation with regards to Anti- Money Laundering and Terrorist Financing Prevention in its operations and manner of doing business. Being a covered person, the Bank shall respect and comply fully with relevant and applicable laws, rules and standards pertaining to Anti Money Laundering and Terrorists Financing Prevention Program.

The Bank has developed and adopted sound risk management policies and practices to ensure that risks associated with ML/TF such as reputational, operational, and compliance risks are identified, assessed, monitored, mitigated, and controlled, as well as to ensure effective implementation of the regulations under BSP, the AMLA, as amended, and its RIRR, to the end that the Bank shall not be used as a vehicle to legitimize proceeds of unlawful activity or to facilitate or finance terrorism.

This sound risk management allows the Bank to have adequate and active Board and Senior Management oversight, acceptable policies and procedures embodied in a Money Laundering and Terrorist Financing Prevention Program (MLPP), appropriate monitoring and Management Information System and comprehensive internal controls and audit. In 2017, the Bank has reviewed and amended its MLPP to comply with the requirements of BSP Circular 950.

Notwithstanding the provisions specifying the duties and responsibilities of the Compliance Office and Internal Audit, it is the Bank's Board of Directors' ultimate responsibility to fully comply with the provisions of the rules under the Bank's MLPP. For this reason, it ensures that oversight on the Bank's AML/TF compliance management is adequate.

Senior Management oversees the day-to-day management of the Bank and ensures effective implementation of AML/TF policies approved by the Board and alignment of activities with the strategic objectives, risk profile and corporate values set by the Board. Senior management has established a management structure that promotes accountability and transparency and upholds checks and balances.

Management of the implementation of the Bank's Money Laundering and Terrorist Financing Prevention Program (MLPP) is the primary task of the Compliance Officer, who shall have direct reporting line to the Board of Directors or to any Board-level or approved committee on all matters related to AML and TF compliance and their risk management.

On the other hand, the evaluation of the Bank's risk management related to ML and Terrorist Financing and adherence to internal control mechanisms related to customer identification process is the task of the Internal Audit.

Compliance Risk for AML and TF is monitored manually thru an excel file generator that extracts reportable Covered Transactions (CTR) from the Bank's MIS while tellers are first line defenses that determines possible reportable Suspicious Transactions (STR) by applying enhanced due diligence and based on the provisions of the Bank's MLPP.

Corporate Governance

SOUTH BANK (A RURAL BANK), INC. believes in the principles of good governance as derived from leading best practices internationally and on a national level.

SBI affirms its commitment to good corporate governance anchored on the philosophy of integrity, accountability and transparency in the conduct of its business; fairness in its dealings with clients, investors, employees, stockholders and the banking public; professionalism in managing the bank and respect for governing laws and regulations; and adheres to the principle of rational checks and balances and a structured approach to its operating processes.

The Board of Directors and Management, Officers and Staff, of the Bank hereby commit to the principles and best practices contained in its Corporate Governance Manual, and acknowledge that it is a necessary component of a sound strategic business management towards attainment of corporate goals.

Board of Directors

Compliance with the principles of good corporate governance shall start with the Board of Directors or the "Board". It is the Board's responsibility to foster the long-term success of the Bank, and to sustain its competitiveness and profitability in a manner consistent with its fiduciary responsibility, which it shall exercise in the best interest of the Bank, their shareholders and other stakeholders.

The Board is primarily responsible for approving and overseeing the implementation of the Bank's strategic objectives and business plans, risk strategy, corporate governance and corporate values. It shall hold regular and special meetings to discuss senior management's performance vis à vis the Bank's strategic plan and annual budget, as well as policies and developments in the areas of risk management, corporate governance, compliance, and relevant operational functions.

South Bank is headed by competent and working board that oversees the implementation of the Bank's strategic objectives, governance framework and corporate values.

Board Composition

The Board is composed of nine members, all of whom, other than the President and CEO, serve as non- executive directors and operate independently of management. However, according to BSP Circular 969, directors are not allowed to hold office as corporate secretary, thus, in May 2018 stockholders' meeting, the Board appointed a non-director corporate secretary. Nominated and voted by shareholders every year, each director serves a one-year term until the election of another set of directors.

The Bank recognizes increasing diversity at the Board level as an essential element in maintaining a competitive advantage and achieving long-term growth and profitability. In determining the appropriate Board composition, Board diversity shall consider professional experience, skills, knowledge, background, moral standing in the community and other distinctions between Directors. All Board appointments are made on merit, in the context of the integrity and reputation, skills, experience, independence and knowledge which the Board as a whole requires to be effective.

Through the Board's Corporate Governance Committee, the Bank ensures that all directors are qualified for election based on their integrity, physical fitness, competence, education, moral standing in the community, and relevant business or banking experience, among others. The Bank does not discriminate against gender, age, and ethnic, political, religious, or cultural backgrounds.

Director	Position / Type of Director	No. of Years as Director	Total No. of Direct (D) and Indirect (I) Shares held as of December 31, 2018	% to Total Outstanding Shares
Dr. Rafaelita P. Pelaez	Chairman of the Board Non-Executive Director	13	12,524,600.00	27.23
Mr. Wilhelmino R. Mendoza	President and CEO Executive Director	5	4,956,900.00	10.78
Dr. Mariano M. Lerin	Non-Executive Director	13	7,848,800.00	17.06
Dr. Alain Marc P. Golez	Non-Executive Director	13	4,814,000.00	10.47
Engr. Elpidio M. Paras	Independent Director	13	166,500.00	0.36
Dr. Ferdinand M. Rodriguez	Independent Director	2 years & 7 months	500.00	0.00
Dr. Anselmo B. Mercado	Independent Director	2 years & 7 months	500.00	0.00
Mr. Jaime Rafael U. Paguio	Non-Executive Director	2 years & 3 months	100.00	0.00
Atty. Ramon M. Velez	Non-Executive Director	1 year & 9 months	100.00	0.00

Independent, Executive and Non-executive Directors

Independent directors are established to reinforce the Board's independence in order to provide independent and objective judgment on significant corporate matters and ensure that key issues and strategies are objectively reviewed, constructively challenged, thoroughly discussed and rigorously examined. In 2017, three of the nine directors or 33.33% are Independent Directors, which exceeds the requirement of BSP for banks classified as simple bank.

The President and CEO of the Bank, being an executive director, ensures that orders and resolutions of the Board and BSP circulars, rules and regulations governing rural banks are carried into effect. He shall have direct and immediate supervision over the long-term and daily operations and management of the Bank and shall execute and administer the administrative and operational policies approved by the Board.

The non-executive directors, on the other hand, are not involved in the day by day management operations of the Bank to promote independent oversight of management.

Chairman of the Board

The Chairperson is primarily responsible for leading the Board and ensuring its effectiveness. She provides independent leadership to the Board, fosters constructive relationship between Directors, promotes an open environment for critical discussions and constructive debate on key issues and strategic matters, and ensures that the Board of Directors exercises strong oversight over the Bank's business and performance of senior management. She takes a lead role in ensuring that the Board provides effective governance of the Bank and continues to operate at a very high standard of independence with the full support of the directors.

Board of Directors

Dr. Rafaelita P. Pelaez

Chairman

Non-Executive Director

Filipino, 69

Dr. Rafaelita P. Pelaez has been the Bank's Chairman and majority stockholder since February 2005 when the Pelaez family acquired it in 2004. She is the Chairman of the ZEALEP Group of Companies with business interests in education, real estate and finance among others. Aside from the Bank, these corporations in which she heads either as Chairman and/or President are: Liceo de Cagayan University, Zealep, Inc., Gopel Finance Corporation, Factors Lending Corporation, Paseo del Rio, Zealep Hotels Inc., Bently Realty and Development Corporation, Cagayan de Oro Academy for International Education, Divine Shepherd Memorial Gardens, Zealep Insurance Agency and Allied Services, Pelaez-Golez Management Corporation, Zealep Holdings, Inc., Rodolfo N. Pelaez Foundation, and Propiedades Maternales, Inc. She holds a Bachelor of Arts degree from Colegio dela Immaculada Conception, a Master of Arts in Literature from University of San Carlos and Doctor in Management from University of San Jose Recoletos. She has attended the Corporate Governance Seminar conducted by Rural Bankers Association of the Philippines (RBAP).

Mr. Wilhelmino R. Mendoza

President and CEO

Executive Director

Filipino, 70

Mr. Wilhelmino R. Mendoza has been the Bank's President and Chief Executive Officer and Director since December 2013. He has also been Director of Gopel Finance Corporation and Factors Lending Corporation. Mr. Mendoza has worked in the banking industry for more than forty (40) years and has attended many leadership management and financial trainings and seminars, foremost of which are his attendance in the Pacific Rim Bankers Program at the University of Washington in Seattle, USA and a Leader Program conducted by the National Defense College in Taguig, Metro Manila. He worked in various capacities in other banks. He started his banking career at the Philippine National Bank and rose to become manager of Republic Planters Bank. Afterwards he became Vice President and Region Head of Land Bank of the Philippines and Solidbank Corporation and until his retirement in 2013, as First Vice President and Area Head of BDO Unibank. For a time, he also worked as Senior Vice President and Consultant of A. Brown Company and other affiliates of the said group in Cagayan de Oro. Mr. Mendoza holds a Bachelor of Arts degree from Ateneo de Zamboanga. He has attended the Corporate Governance Seminar and Advance Corporate Governance Course conducted by RBAP last September 2016 and October 2017, respectively.

Dr. Mariano M. Lerin

Non-Executive Director

Filipino, 77

Dr. Mariano M. Lerin has been a Director of the Bank since 2005 and corporate secretary until 2018. He has been President of Liceo de Cagayan University since 2007. Dr. Lerin holds directorship and officership positions in Gopel Finance Corporation, Factors Lending Corporation, Paseo del Rio, Zealep Hotels, Inc., Bently Realty and Development Corporation, Divine Shepherd Memorial Gardens, Zealep Insurance Agency and Allied Services, Inc., Zealep Holdings, Inc. and Propiedades Maternales, Inc as Director; and Cagayan de Oro Academy for International Education as Director and Corporate Secretary. He is an accomplished educator and has been faculty and dean of various schools before joining Liceo de Cagayan University. He was President of Philippine Institute of Certified Public Accountants (PICPA) in 1991 and of ASEAN Federation of Accountants (AFA) in 1996. He has attended various seminars in his field, including Corporate Governance Seminar which was conducted by RBAP in 2016. He holds a Bachelor of Science degree in Commerce from University of San Carlos, AB Economics from University of San Carlos, Bachelor of Science in Education Major in Economic from University of San Jose Recoletos, Master in Business Administration from University of San Jose Recoletos and Doctor in Management from University of Sto. Tomas.

Dr. Alain Marc P. Golez

Non-Executive Director

Filipino, 42

Dr. Alain Marc P. Golez has been a Director of the Bank since 2005.He has also been the Bank's Treasurer from 2005 to 2018.Dr. Golez also holds directorship and officership positions in Gopel Finance Corporation, Factors Lending Corporation, Paseo del Rio, Zealep Hotels, Inc., Bently Realty and Development Corporation, Divine Shepherd Memorial Gardens, and Pelaez-Golez Management Corporation as Corporate Secretary; Cagayan de Oro Academy for International Education and Golez and Golez Ventures as President; Zealep Holdings, Inc. as Chief Executive Officer; Liceo de Cagayan University as Vice President and Corporate Secretary; and Zealep, Inc. and Zealep Insurance Agency and Allied Services as Director. He holds a Bachelor of Arts degree major in English from San Carlos University, Master in Entrepreneurship from Asian Institute of Management and Doctor in Philosophy Major in Commerce from University of Sto. Tomas. He attended the Corporate Governance Seminar in 2016.

Engr. Elpidio M. Paras
Director
Filipino, 67

Engr. Paras has been a Director of the Bank since 2005. Engr. Paras is one of Cagayan de Oro City's prominent and pioneering businessmen. He is the President and CEO of UC-1 Corporation, Parasat Cable TV, Inc., Arriba Telecontact Inc. and Paramedix Inc. His newest business establishment, Seven Seas, is a popular and the only water sports adventure park in Cagayan de Oro City. He has been the President of Cagayan De Oro Chamber of Commerce and Chairman of the Board of Trustees of Xavier University in 2007. Engr. Paras holds a Bachelor of Science degree in Mechanical Engineering from De Lasalle University. He attended the Corporate Governance Seminar in 2016.

Atty. Ramon M. Velez
Director
Filipino, 56

Atty. Ramon M. Velez has been elected as a Director of the Bank on March 9, 2017. He is the Senior Manager for Legal Services at Del Monte Philippines, Inc. He is also engaged in restaurant business. Atty. Velez holds a degree in AB Economics from Xavier University and Bachelor of Laws from University of the Philippines. He attended the Corporate Governance Seminar on September 2017.

Mr. Jaime Rafael U. Paguio
Director
Filipino, 76

Mr. Jaime Rafael U. Paguio has been a Director of the Bank since 2016. He is the Vice President of CEPALCO and Vice President for Mindanao Operation of CEPALCO Energy Services Corporation. He is also a Trustee of Cagayan de Oro Chamber of Commerce and Industries. He holds a Bachelor of Science degree in Economics from Xavier University, Finance Economy Analysis from Colorado School of Mines and Management of Electric Power Industry from Swed Power, Sweden. He attended the Corporate Governance Seminar on January 2017.

Dr. Anselmo B. Mercado
Independent Director
Filipino, 76

Dr. Anselmo B. Mercado has been one of the Bank's Independent Directors since 2016. He is the Chairman of the Board of Water Consumers Cooperative, Cagayan de Oro Cooperative Advisory Committee, and First Community Credit Cooperative Foundation (FCOF). He served as Dean of Xavier University-College of Agriculture and previously holds directorship on various institutions. Dr. Mercado holds a Bachelor of Science degree in Agriculture Major in Animal Science from Xavier University, Master of Science in Education, Virginia Polytechnic Institute & State University and Doctor of Philosophy major in Adult and Extension Education from North Carolina State University. He attended the Corporate Governance Seminar in 2016.

Dr. Ferdinand A. Rodriguez
Independent Director
Filipino, 53

Dr. Ferdinand A Rodriguez has been one of the Bank's Independent Directors since 2016. He is a Certified Public Accountant and is the Managing Director of FAR Management Consultancy and Accounting Office and the Review Director of Professional Review and Training Center (PRTC) – Cagayan de Oro City. He has been the President of Philippine Council of Deans and Educators in Business in 2014 upto 2017; President of National Association of CPAs in Education in 2014 upto 2015. He was appointed as Second Member of Professional Regulation Commission-Continuing Professional Development Council for Accountancy in 2017. He is also the Regional Director of Philippine Institute of Certified Public Accountants since 2018 and National Director of Association of Certified Public Accountants in Public Practice since January 2019. He holds a Bachelor of Science degree in Accountancy from Polytechnic University of the Philippines, Master of Business Administration from Xavier University and Doctor in Management from Capitol University in Cagayan de Oro City.

Board Committees

To aid the effective performance of the Board's function and comply with the principles of good corporate governance, board level committees are established. South Bank's Corporate Governance Manual provides for eight committees to support the Board. The Manual clearly defines the composition, respective purposes, duties and responsibilities, conduct of meetings and other relevant information which are approved by the Board for each of the board level committees.

Executive Committee

Chairman: Wilhelmino R. Mendoza

Co-Chairman: Rafaelita P. Pelaez

Members:
Alain Marc P. Golez
Mariano M. Lerin
Ferdinand A. Rodriguez (ID)
Elpidio M. Paras
Anselmo B. Mercado (ID)
Jaime Rafael U. Paguio
Ramon M. Velez

Functions: The Executive Committee shall have the power to direct the business of the Bank vested by law in the Board of Directors insofar as such powers and authority may be lawfully delegated to the Executive Committee, including the power to review and approve proposals and transactions related to credit in amounts within the limits of its delegated authority, asset recovery and real and other properties acquired.

Audit and Compliance Committee

Chairman: Ferdinand A. Rodriguez (ID)

Members:
Anselmo B. Mercado (ID)
Mariano M. Lerin
Elpidio M. Paras
Jaime Rafael U. Paguio

Functions: The Audit and Compliance Committee shall assist the Board in the performance of its oversight responsibility for the financial reporting process, system of internal control, audit process, and monitoring of compliance with applicable laws, rules and regulations. It also performs oversight financial management functions, specifically on risk management and internal control functions, it further evaluates and approves the plans of the internal and external auditors.

Related Party Transactions Committee

Chairman: Anselmo B. Mercado (ID)[1]

Members: Ferdinand A. Rodriguez (ID)
Elpidio M. Paras
Jaime Rafael U. Paguio
Ramon M. Velez

Functions: The Related Party Transactions Committee shall assist the Board in ensuring that transactions with related parties are handled in a sound and prudent manner, with integrity and in compliance with applicable laws and regulations to protect the interest of depositors, creditors and other stakeholders and RPTs are conducted on an arm's length basis and that no stakeholder is unduly disadvantaged.

Corporate Governance Committee

Chairman: Jaime Rafael U. Paguio [2]

Members: Ferdinand A. Rodriguez (ID)
Elpidio M. Paras
Anselmo B. Mercado (ID)
Mariano M. Lerin

Functions: The Corporate Governance Committee shall assist the Board in fulfilling its corporate governance responsibilities.

Nomination Committee

Chairman: Wilhelmino R. Mendoza

Co-Chairman: Mariano M. Lerin

Members: Alain Marc P. Golez
Ramon M. Velez
Ferdinand A. Rodriguez

Functions: The Nomination Committee shall review and evaluate the qualifications of all persons nominated to the Board as well as those nominated to other positions requiring appointment by the Board, and assess the effectiveness of the Board's process and procedures in the election or replacement of directors in accordance with the provisions of the Bank's Corporate Governance Manual.

[1]Replaced Mr. Jaime Rafael U. Paguio as Chairman of Related Party Transactions Committee on July 03, 2018

[2]Replaced Mr. Wilhelmino R. Mendoza as member of Corporate Governance Committee on January 26, 2018 and replaced Dr. Anselmo B. Mercado as Chairman of Corporate Governance Committee on July 03, 2018

Compensation and Remuneration Committee

Chairman: Rafaelita P. Pelaez

Co-Chairman: Wilhelmino R. Mendoza

Members: Dr. Anselmo B. Mercado (ID)
Mariano M. Lerin
Elpidio M. Paras

Functions: The Compensation and Remuneration Committee shall establish a forma and transparent procedure for developing a policy on executive remuneration and for fixing the remuneration packages of Officers and Directors. The Committee shall also oversee the remuneration of Senior Management and key personnel to ensure that the compensation is consistent with the Bank's culture, strategy and control environment.

Risk Management and Pricing Committee

Chairman: Wilhelmino R. Mendoza

Co-Chairman: Mariano M. Lerin

Members: Alain Marc P. Golez
Elpidio M. Paras
Ferdinand A. Rodriguez (ID)

Functions: The Compensation and Remuneration Committee shall establish a formal and transparent procedure for developing a policy on executive remuneration and for fixing the remuneration packages of Officers and Directors. The Committee shall also oversee the remuneration of Senior Management and key personnel to ensure that the compensation is consistent with the Bank's culture, strategy and control environment.

Information Technology Committee

Chairman: Elpidio M. Paras

Members: Wilhelmino R. Mendoza
Alain Marc P. Golez
Jaime Rafael U. Paguio
Ferdinand A. Rodriguez (ID)

Functions: The Compensation and Remuneration Committee shall establish a formal and transparent procedure for developing a policy on executive remuneration and for fixing the remuneration packages of Officers and Directors. The Committee shall also oversee the remuneration of Senior Management and key personnel to ensure that the compensation is consistent with the Bank's culture, strategy and control environment.

Board and Committee Meetings

From the period June 2018 to June 2019 (election year), the member's attendance at Board and Committee meetings are as follows:

DIRECTORS	BOARD			ACC			RPT			CG		
	M	A	%	M	A	%	M	A	%	M	A	%
Rafaelita P. Pelaez	8	6	75.00									
Wilhelmino R. Mendoza	8	8	100.00									
Mariano M. Lerin	8	7	87.50	5	4	80.00				1	1	100.00
Alain Marc P. Golez	8	6	75.00									
Elpidio M. Paras	8	6	75.00	5	4	80.00	4	4	100.00	1	1	100.00
Ramon M. Velez	8	6	75.00				4	4	100.00			
Jaime Rafael U. Paguio	8	6	75.00	5	4	80.00	4	4	100.00	1	1	100.00
Anselmo B. Mercado	8	8	100.00	5	4	80.00	4	4	100.00	1	1	100.00
Ferdinand A. Rodriguez	8	7	87.50	5	5	100.00	4	4	100.00	1	1	100.00

M = Number of Meetings
A = Meetings Attended

Note: In 2018, only three board-level committees were activated, namely the Audit and Compliance Committee, Related Party Transactions Committee and Corporate Governance Committee, which are the minimum required committees for South Bank in relation to its size and complexity of operation.

Senior Management

WILHELMINO R. MENDOZA[1]
President and CEO
Filipino, 70

Mr. Wilhelmino R. Mendoza has been the Bank's President and Chief Executive Officer and Director since 2013. He holds a Bachelor of Arts degree from Ateneo de Zamboanga.

SYLVIA C. TALA-O
Junior Assistant Vice President
Bank Operations Manager
Filipino, 45

Ms. Sylvia C. Tala-o has been appointed as Bank Operations Manager and promoted as Junior Assistant Vice President on May 16, 2018. Ms. Tala-o joined SBI in 2011. Prior to the position, she has been a Compliance Officer, Remedial and Collection Head, Business Manager, Main Office Manager, Credit Unit Head, and Marketing Officer of the Bank. Also, prior to joining SBI, she has been with Siam Bank since 2002 up to 2011. She holds a Bachelor of Science degree in Accountancy from Mindanao State University-Iligan Institute of Technology.

ARGINE MAY M. RAMO
Acting Compliance Officer
Filipino, 26

Ms. Argine May M. Ramo was appointed as the Bank's Compliance Officer in Acting Capacity in April 2018. Prior to the position, she became the Bank's Internal Auditor in 2017, In-Charge of Office of Velez Branch in 2016, and subsidiary and general bookkeeper in 2014 to 2015. She holds a Bachelor of Science degree in Management Accounting and in Accountancy from Central Mindanao University. Ms. Ramo is a Certified Public Accountant and has attended various seminars that apprised her of the banking regulations necessary for the effective management of the Bank's compliance function.

JOWARD CLINTON C. CAVALIDA
Acting Internal Auditor
Filipino, 33

Mr. Joward Clinton C. Cavalida was appointed as the Bank's Internal Auditor in March 2019 in acting capacity. Prior to joining the Bank, he has been an Instructor at Lourdes College, Assistant Accountant at Home to Home and Accounting Assistant at Union Logistics in Dubai. Mr. Cavalida holds a Bachelor of Science degree in Accountancy from Lourdes College.

ELLEN S. FLORES
Credit Officer II
Filipino, 33

Ms. Ellen S. Flores is one of the Bank's Credit Officers. She has been in the credit unit since March 2014 and has been a bookkeeper for one year prior to becoming the Credit Unit Head in 2014. Prior to joining the Bank, Ms. Flores has worked as bookkeeper and accountant at Siam Bank, Inc. (A Rural Bank) in 2008 to 2011 and as bookkeeper at RBT Bank in 2011 to 2012. She has also attended various seminars that are necessary in the conduct of her current position. Ms. Flores holds a Bachelor of Science degree Major in Banking and Finance from Bukidnon State University.

ERVIN S. BALANDAN
Credit Officer I
Filipino, 41

Mr. Ervin S. Balandan is one of the Bank's Credit Officers. He joined the Bank in 2017 as Assistant Compliance Officer before being appointed as Credit Officer I in January 2018. Prior to joining the Bank, Mr. Balandan has been the Sales and Purchase Coordinator at Hamy International from 2013 to 2015 and Operations Manager/Project Coordinator at AGB Development Foundation, Inc. He has also worked in the banking industry under RBT bank, Inc. from 2001-2009. Mr. Balandan holds a degree in AB Economics from Ramon Magsaysay Memorial College and Master in Management from Liceo de Cagayan University.

[1]Refer to Board of Directors

KRISCHILLE MAE G. ACERO
Accountant
Filipino, 27

Ms. Krischille Mae G. Acero has been the Accountant of the Bank since 2012 when she first joined the Bank and reappointed again in August 2017. Ms. Acero became Internal Auditor of the Bank in January 2014, Acting Compliance Officer in May 2014 and Asst. Compliance Officer in January 2017. She attended various seminars to apprise her of bank regulations and developments in her profession. Ms. Acero is a Certified Public Accountant. She holds a Bachelor of Science degree in Accountancy from Central Mindanao University.

MA. EVA A. CAHOY[1]
Central Cashier
Filipino, 32

Ms. Ma. Eva A. Cahoy has been the Bank's Central Cashier since January 2017. Ms. Cahoy joined the Bank in November 2011 as Teller; became New Accounts Clerk, Clearing Clerk and Bookkeeper in 2012; Accountant in 2014; Loans Supervisor, Acting Branch In-Charge of Office and Branch Cashier in 2015. She holds a Bachelor of Science degree in Accountancy from Fatima College of Camiguin.

JOHNSON S. VALDON[2]
Remedial Management and Collection Unit Head
Filipino, 41

Mr. Johnson S. Valdon has been the Bank's Remedial Management and Collection Unit Head upon joining the Bank in 2016. Prior to South Bank, Mr. Valdon has worked in Megamitch Financial Corporation as Credit and Collection Supervisor for a year and in RBT Bank for 11 years from Account Officer to Internal Audit Supervisor.
In 2017, Mr. Valdon has attended the Portfolio Management Seminar conducted by Ateneo de Manila University. Mr. Valdon holds a Bachelor of Science degree in Accountancy from Stella Maris College.

ROBEMAR S. CASTILLON
IT Unit Head
Filipino, 30

Mr. Robemar S. Castillon has been Head of the Bank's IT Unit since June 2017. He has been with the Bank since 2012 as IT Specialist. He attended various seminars that apprised him regulations governing banks in relation to information and information technology. In 2017, he attended the Credit Information Corporation Trainings and Seminar conducted by CIC and Data Privacy Act Seminar conducted by National Privacy Commission. He has also attended Cyber Security Awareness Training & Seminar, Cloud Computing and Fujitsu Business Solutions: Technology update conducted by private institutions. Mr. Castillon holds a Bachelor of Science degree in Information Technology from Mindanao University of Science & Technology.

GERNA KRISTEL T. PINEDA
Administrative Services Unit Head
Filipino, 32

Ms. Gerna Kristel T. Pineda has been the Bank's Administrative Services Unit Head since 2016. Prior to ASU Head, Ms. Pineda started as Loans Bookkeeper upon joining SBI in 2010; Loans Processor in 2011; Cashier/New Accounts Clerk in 2012 and Internal Auditor in 2014. Ms. Pineda has attended various seminars necessary in her position. She represents SBI in the People Management Association of the Philippines (PMAP). Bachelor of Science in Management Accounting, Ateneo de Cagayan-Xavier University and has attended a seminar on Digitizing and Simplifying HR and Payroll Performance conducted by PMAP in 2018. Ms. Pineda holds a Bachelor of Science degree in Business Administration and Masters in Business Administration from Ateneo de Cagayan-Xavier University.

[1]Resigned in January 2019 and rejoined the Bank in May 2019 as Cashier of Velez Branch
[2]Resigned in ___ 2019

Performance Assessment Program

The Bank, thru the Corporate Governance Committee, oversees the periodic evaluation of contribution and performance of its directors, the Board, board-level committees and senior management. This covers the assessment of the ongoing suitability of each member in accordance to the qualification and disqualification criteria as provided in MORB, taking into account his or her performance as member of the Board and board-level committees.

A yearly self-assessment, using an approved scorecard, is conducted focusing on their performance based on the established performance standards of the Bank that are consistent with the Bank's strategic objectives. These scorecards are given to each director. Each of them is required to complete the scorecard and return the same. The ratings are tabulated and consolidated. The result is reported to the Board.

Orientation and Education Program

Under the Bank's Corporate Governance Manual, all new directors must undergo proper orientation upon joining the Board. This ensures that new members are appropriately apprised of their duties and responsibilities before beginning their directorships.

In addition to the orientation, first time directors shall, before assuming as such, be required to attend a seminar on corporate governance which shall be conducted by a duly recognized private or government institution. The directors are required to submit a certification of compliance of this requirement to BSP. They also undergo continuing education that covers update on matters relevant to the Bank.

Senior management officers also undergo orientation prior to beginning their officership and continuing education thru external and internal training program the Bank has set in order to apprise them and to ensure that they continually possess the qualifications for the position.

Retirement

The Board did not set a retirement age for its directors. While a director may seat in the Board for a term of one year and may be re-elected, a director who ascertains that he/she is no longer fit to perform his/her functions shall refuse nomination, if not yet elected, or may opt to retire, if already elected.

Succession Policy

Succession planning is established as part of the Bank's business continuity program to ensure that the Bank's leadership has adequate information and strategy to effectively manage the Bank in the event of unplanned and unexpected changes in the organization. The plan outlines a leadership development and emergency succession plan for the Bank and its commitment to sustaining a healthy functioning organization. It is periodically reviewed and updated and trainings are conducted accordingly.

In the Board, any vacancies may be filled by the vote of at least a majority of the remaining directors, if still constituting a quorum, provided, that any vacancy occurring by reason of removal by stockholders, by expiration of term or increase in the number of directors shall be filled by the stockholders in a regular or special meeting called for the purpose.

Remuneration

Currently, the Bank has no policy on remuneration. However, the Bank's current practices are aligned with labor laws and regulations and competitive with industry standards geared toward retaining and motivating human resource.

The Bank's By-Laws provides that directors shall not receive any remuneration, as such directors, except for reasonable per diems. Only the President and CEO of the executive directors is entitled to remuneration benefit by virtue of being officer of the Bank. All Directors are entitled to a specific per diem for attendance to board meetings and on board level committee meetings.

The remuneration of the senior management is commensurate to individual's qualification and experience, nature of job, position and level of responsibilities with reference to approved salary scale. The Bank grants increase based on Bank and individual performance based thru annual appraisal.

The four (4) most highly compensated management officers are the President and CEO, Bank Operations Manager, Valencia Branch Manager and Credit Unit Head.

Related Party Transactions

The Bank has established policies and procedures on related party transactions which are embodied in the DOSRI and Related Party Transactions Policy of the Bank1. These include definition of related parties, coverage of RPT policy, guidelines in ensuring arm's-length terms, managing conflict of interest, adoption of materiality thresholds, and internal limits for individual and aggregate exposures. The RPT Committee reviews and endorses to the Board for final approval all material RPTs. The Related Party Transactions policy applies to South Bank's DOSRI and affiliates, as applicable and intended to ensure that every related party transaction is conducted in a manner that will protect the Bank from conflict of interest which may arise between the Bank and its Related Parties; and proper review, approval, ratification and disclosure of transactions between the Bank and any of its related party/ies as required in compliance with legal and regulatory requirements. The policy provides for the responsibility of the RPT Committee where it requires that any member of the RPT Committee who has a potential interest in any related party transaction shall abstain from the discussion and endorsement of the related party transaction and any member of the Board who has an interest in the transaction must abstain from the deliberation and approval of any related party transaction.

Material Related Party Transactions

For the Year 2018

Related Counterparty	Nature of Transactio n/ Type of Transactio	Terms	Amount/ Contract Price	Outstanding Balance	Rationale for Entering into the Transaction
DOSRI					
PG Management Corp.	Human Resource Development services	Continuing contract	P 30,000.00 Monthly service fee	Not applicable.	To outsource services on hiring and recruitment, employee orientation, wage administration and many others
Cleanmate Manpower and Janitorial Services	Janitor ial Servic es	Renewable annually	P11,803.0/ month/janitor or utility	Not applicable.	To outsource two (2) utility personnel for Cagayan de Oro Branches
Liceo de Cagayan University	Office Rental of RNPelaez	various dates	41,250.00	Not applicable.	Branch' Office Rental
Bently Realty & Devt. Corp.	Office Rental-	1 year	45,314.50	Not applicable.	Branch' Office Rental
Bently Realty & Devt. Corp.	Office Rental-	1 year	12,684.00	Not applicable.	Branch' Office Rental
Rodito B. Rafisura	Office Rental- Kitaotao	5 years	25,000.00	Not applicable.	Branch' Office Rental
Francis Joseph R. Mendoza[1]	**Sales Contract**	2 years	220,000.00	109,368.37	Purchase of Bank's ROPA
Total-DOSRI			2,354,254.00	109,368.37	
RELATED PARTIES					
Diosdado Lugto	Loan Availment	15 years	150,000.00	63,150.59	Loans and Receivables
Leo Paolo Perez	Loan Availment	1 year	250,000.00	250,000.00	Loans and Receivables
Ellen G. Julieza	Loan Availment	2 years	140,000.00	70,000.04	Loans and Receivables
Total-Related Parties			390,000.00	383,150.63	

Compliance

The compliance function of the Bank facilitates the effective management of compliance risks or risks of legal or regulatory sanctions, material financial loss, or loss to reputation that a bank may suffer as a result of its failure to comply with laws, rules, related self-regulatory organization standards, and codes of conduct applicable to its activities. The Compliance Function is headed by the Chief Compliance Officer (CCO). The Compliance Function is a separate and independent unit with no business function. It reports to the Board of Directors through the Audit and Compliance Committee.

Internal Audit

The Bank has in placed an independent internal audit function who functionally reports to the Audit and Compliance Committee. The Internal Audit is mandated to evaluate the effectiveness as well as recommend appropriate courses of action to senior management and the Board to improve the Bank's risk management, compliance, internal controls and corporate governance process. This encompasses the examination and evaluation of the adequacy and effectiveness of the internal control systems; review of the application and effectiveness of risk management procedures & risk assessment methodologies; review of the management & financial information systems, including the electronic information; Assessment of the accuracy & reliability of the accounting system & of the resulting financial reports; review of the systems & procedures of safeguarding; review of the system assessing capital in relation to the estimate of organizational risk; transaction testing and assessment of specific internal control procedure; and review of the compliance system & the implementation established policies and procedures.

All activities are carried out according to the rules and guidelines as set out in its Manual and Charter and in such a manner that it is consistent with the Standards for the International Standards for the Professional Practice of Internal Auditing and Philippine Standards on Auditing with the professional standards of conduct as per the Code of Professional Ethics for CPAs.

Dividend Policy

The Bank's Corporate Governance Manual provides that the shareholders of the Bank shall have the right to receive dividends subject to the discretion of the Board. The Bank shall be compelled to declare dividends when its retained earnings shall be in excess of 100% of its paid-in capital stock except when justified by definite corporate expansion projects or programs approved by the Board; or when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not been secured; or when it can be clearly shown that such retention is necessary under special circumstances obtaining in the Company, such as when there is a need for special reserve for probable contingencies was not able to declare dividend since the Bank's acquisition.

Corporate Social Responsibility Initiatives

The Bank has not adopted a formal corporate social responsibility program yet. However, in 2018, it continuously support to the corporate social responsibility of its holding company, the Zealep Group of Companies, thru its Safer River Life Saver Foundation, a multi-sectoral endeavor aimed to protect and enhance the ecology of the Cagayan de Oro River, other rivers in Cagayan de Oro City and community extension areas in order to maximize benefits from its utilization. Also, the Bank has supported advocates of community organizations like churches, barangay offices and other foundations by contributing thru donations.

On the other hand, the Bank is now planning its corporate social responsibility endeavor for 2019 in order to help the community and the clientele to where it belongs.

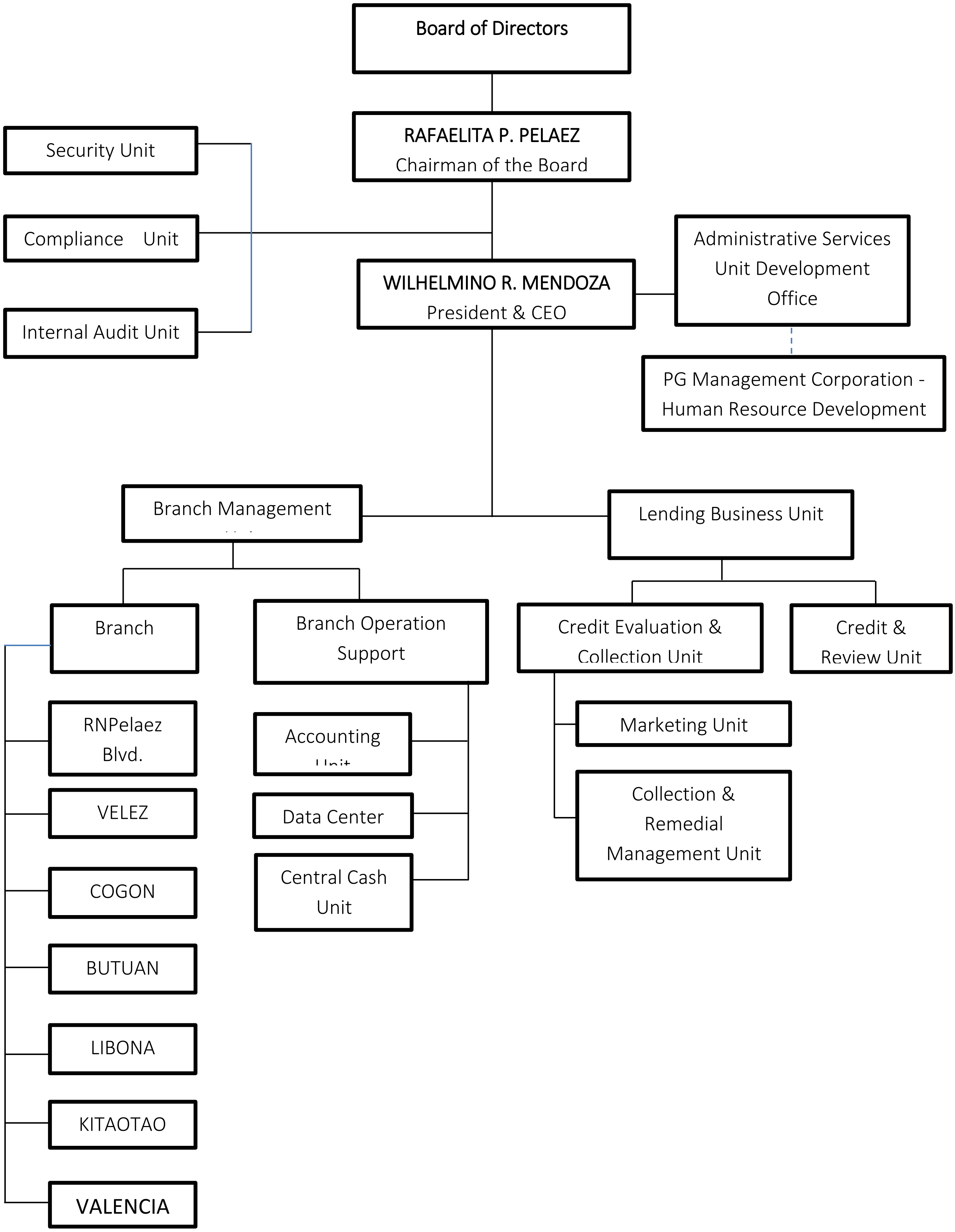
Consumer Protection Practices

The Board of Directors has approved last December 14, 2015 the Financial Consumer Protection Policy of the Bank which provides clear guidance regarding the level of consumer protection risk acceptable to the Bank to maintain a sound Customer Protection Risk Management System that is integrated into the over-all framework for the entire product and service life-cycle. The Bank's Code of Conduct adopted from its holding company, Zealep, reflects the Bank's commitment to ensuring that its customers are always treated fairly and professionally.

Consumer protection practices are embedded in the banking operations, and are considered in the development and implementation of products and services. The Bank follows an operational channel in handling customer complaints. To ensure its effective implementation, it has designated its Branch Heads to serve as the Customer Assistance Officers (CAOs). The CAOs then report to the Administrative Services Unit and/or the Bank Operations Manager for the latter to present and discuss the report on complaints to the Board which will provide action based on the recommendations of the President/CEO.

In 2018, no complaints were reported in any of the bank's branches.

Organizational Structure



Key Officers of South Bank

President and CEO	-	Wilhelmino R. Mendoza
Bank Operations Manager	-	Sylvia C. Tala-o
Acting Compliance Officer	-	Argine May M. Ramo
Acting Internal Auditor	-	Joward Clinton C. Cavalida
Credit Officer I	-	Ervin S. Balandan
Credit Officer II	-	Ellen S. Flores
Accountant	-	Krischille Mae G. Acero
Central Cashier	-	Ma. Eva A. Cahoy
Administrative Services Unit Head	-	Gerna Kristel T. Pineda
Remedial Management and Collection Unit Head	-	Johnson S. Valdon
IT Head	-	Robemar S. Castillon

Major Stockholders

As of December 31, 2018, the following are known to South Bank (A Rural Bank), Inc. to be directly or indirectly the record and beneficial owners of more than 20% of South Bank (A Rural Bank), Inc.'s voting shares:

Title of Class	Name	Nationality	Percentage
Common	Rafaelita P. Pelaez	Filipino	27.23%

Products and Services

DEPOSIT PRODUCTS

Time Deposit
Savings Deposit
Demand Deposit
Kiddie Savers
Safety Deposit Box Facility

LOANS AND CREDIT

Regular Loans

- Agricultural Loans
- Commercial Loans
- Multi-purpose Loans
- OFW/Seafarers Loan
- Microfinance Services

Consumer Loans

- Individual Salary Loans
    - Private companies
    - Government (Ex. PNP, Teachers, etc.)
    - Pension Loan
    - Loans to LGU employees

Other Loans

- Vehicle Acquisition
- Building and House Improvements
- Student Educational Assistance Loan (SEAL)

OTHER SERVICES

Bills Payment

- Parasat
- CEPALCO
- BUSECO
- LDCU

Tuition Remittances
SBI Access Card

Head Office and Branches

South Bank (A Rural Bank), Inc. Head Office & RN Pelaez Branch
Rodelsa Hall, RN Pelaez Boulevard Kauswagan, Cagayan de Oro City 9000
(088) 858-4808/ (088) 858-4832/(08822) 728854

Velez Branch
Southbank Plaza Building Streets Yacapin-Velez Streets Cagayan de Oro City 9000
(088) 852-4158

Cogon Branch
Philippine First Insurance Company Bldg.
J.R. Borja - Aguinaldo Street Cagayan de Oro City 9000
(088) 857-3005

Butuan Branch
Door #A-3 GF, VPH Commercial Building III Ochoa Avenue, Brgy. Dagohoy Butuan City 8600
+63 977 840 0309

Libona Branch
Brgy. Crossing, Libona, Bukidnon 8706
+63 917 308 5604

Kitaotao Branch
Poblacion, Kitaotao, Bukidnon 8716
+63 917 712 1002

Valencia Branch
DBL Bldg., Alkuino corner Catarata Sts. Poblacion, Valencia City, Bukidnon 8709
+63 977 840 0319

Website

www.southbankinc.com

Audited Financial Statements

REPORT OF INDEPENDENT AUDITORS

The Shareholders and the Board of Directors South Bank (A Rural Bank) Incorporated Rodelsa Hall, R.N. Pelaez Boulevard Kauswagan, Cagayan de Oro City

Opinion

We have audited the accompanying financial statements of South Bank (A Rural Bank) Incorporated, which comprise the statement of financial position as of December 31, 2018, and the related statements of comprehensive income, change in shareholders' equity and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of South Bank (A Rural Bank) Incorporated as of December 31, 2018 and of its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards (PFRS).

Basis for Opinion

We conducted our audits in accordance with the 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 together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our 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.

Emphasis of Matter

The financial statements of South Bank (A Rural Bank) Incorporated as of and for the year ended December 31, 2017 were audited by another auditor whose report dated on April 27, 2018 expressed an unqualified opinion on those statements.

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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our 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 audits and significant audit findings, including any significant deficiencies in internal control that we identify during our audits.

Report on Other Legal and Regulatory Requirements

The Bureau of Internal Revenue in its Revenue Regulations 19-2011 requires the Bank to include information on taxes, duties and license fees paid or accrued and other supplemental information during the taxable year in the Notes to Financial Statements. The supplementary information, as discussed in Note 22, is not a required part of the basic financial statements prepared in accordance with the financial reporting standards in the Philippines; nor, a required disclosure or content of the financial statements under the Securities Regulation Code (SRC) Rule 68. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole and such supplementary information is the responsibility of the Management.

Report on Other Requirement

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The applicable supplementary schedules of the Bank as of and for the year ended December 31, 2018 are in compliance with the requirements of the SRC Rule 68. These are presented for purposes of additional analyses and are not required part of the basic financial statements. The information in such supplementary schedules is the responsibility of the management and have 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.

SRD & Co., CPAs TIN 231-991-011

SEC Accreditation No. 0237-FR-1 Effective May 1, 2016 to May 1, 2019

BOA Accreditation No. 0810

Effective December 31, 2016 to December 31, 2019

For the Firm:

Sabino R. Dapat
Partner
CPA Cert. No. 0006537
TIN 131-516-520
PTR No. 1681961
Issued on January 15, 2019 at Cebu City
SEC Accreditation No. 1167-AR-1
Effective May 1, 2016 to May 1, 2019
BIR Accreditation No. 13-000017-001-2017
Effective September 26, 2017 to September 26, 2020

March 14, 2019

SOUTH BANK (A RURAL BANK) INCORPORATED

STATEMENT OF FINANCIAL POSITION
December 31, 2018
(With Comparative Figures for 2017)

	Notes	2018	2017
ASSETS			
Cash and Other Cash Items	4	₱ 7,071,057	₱ 5,488,172
Due from Bangko Sentral ng Pilipinas (BSP)	5	9,748,344	8,535,382
Due from Other Banks	6	49,697,101	52,573,036
Loans and Receivables – net	7	309,186,518	273,429,220
Unquoted Debt Securities Classified as Loans	8	1,950,056	1,950,056
Investment properties – net	9	7,615,397	4,962,299
Bank Premises, Furniture, Fixtures and Equipment – net	10	10,391,886	9,175,211
Other Intangible Assets	11	873,001	2,120,591
Pension Asset	21	642,644	-
Deferred Tax Assets	20	9,062,422	9,060,497
Other Assets – net	12	6,420,876	9,538,163
Total Assets		₱ 412,659,302	₱ 376,832,627
LIABILITIES AND SHAREHOLDERS' EQUITY			
Deposit Liabilities	13	₱ 234,320,737	₱ 249,090,956
Bills Payable	14	100,003,539	57,086,520
Accrued Interest and Other Expenses	15	5,760,781	3,361,120
Accrued Retirement	21	-	455,164
Income Tax Payable	20	61,342	2,397,714
Deferred Tax Liability	20	192,793	-
Other Liabilities	16	2,599,874	2,809,910
		342,939,066	315,201,384
Capital Stock			
Preference Shares – ₱ 100 par value			
Authorized – 40,000 shares			
Ordinary Shares – ₱ 100 par value			
Authorized and issued – 460,000 shares	17	46,000,000	46,000,000
Share Premium	17	7,030	7,030
		46,007,030	46,007,030
Stock Dividends Distributable	17	14,000,000	-
Retained Earnings		9,137,152	15,525,399
Cumulative Remeasurement Gain on Retirement Plan	21	576,054	98,814
		69,720,236	61,631,243
Total Liabilities and Shareholders' Equity		₱ 412,659,302	₱ 376,832,627

See accompanying Notes to Financial Statements.

SOUTH BANK (A RURAL BANK) INCORPORATED

STATEMENT OF COMPREHENSIVE INCOME
For the Year Ended December 31, 2018
(With Comparative Figures for 2017)

	Notes	2018	2017
Interest income and other fees			
Loans and receivables	7	₽ 49,153,119	₽ 48,062,938
Deposits with banks and investments	6, 8	371,571	374,019
		49,524,690	48,436,957
Interest expense on deposit liabilities	13	(4,509,491)	(4,608,034)
Interest expense on bills payable	14	(7,253,306)	(3,730,249)
Net interest income		37,761,893	40,098,674
Provisions for expected credit losses	7, 12	(2,712,830)	(12,822,027)
Net interest income after provision for credit and impairment losses		35,049,063	27,276,647
Other operating income	19	17,963,459	17,360,596
Administrative expenses	19	(41,938,234)	(35,014,348)
Profit before income tax		11,074,288	9,622,895
Income tax expense	20	(3,462,535)	(2,820,948)
Profit		7,611,753	6,801,947
Other comprehensive income			
Remeasurement gains on retirement plan		681,771	467,175
Tax relating to remeasurement gains on retirement plan		(204,531)	(140,152)
		477,240	327,023
Total comprehensive income		₽ 8,088,993	₽ 7,128,970
Earnings per share		₽ 16.55	₽ 14.79

See accompanying Notes to Financial Statements.

SOUTH BANK (A RURAL BANK) INCORPORATED
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Year Ended December 31, 2018

(With Comparative Figures for 2017)

	Capital Stock	Share Premium	Retained Earnings	Stock Dividends Distributabl	Remeasurement gains(losses) on Retirement plan	Total
Balance at January 1, 2017	₱46,000,000	₱ 7,030	₱8,723,452	₱ -	(₱228,209)	₱54,502,273
Net income for the year			6,801,947			6,801,947
Remeasurement gain					327,023	327,023
Balance at December 31, 2017	46,000,000	7,030	15,525,399	-	98,814	61,631,243
Stock dividend declaration (Note 17)				(14,000,000)		14,000,000
Remeasurement gain (Note 22)					477,240	477,240
Net income for the year			7,611,753			7,611,753
Balance at December 31, 2018	₱ 46,000,000	₱7,030	₱9,137,152	₱ 14,000,000	₱576,054	₱ 69,720,236

See accompanying Notes to Financial Statements.

SOUTH BANK (A RURAL BANK) INCORPORATED
STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2018
(With Comparative Figures for 2017)

	Notes	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before income tax		₱ 11,074,288	₱ 9,622,895
Adjustments for:			
Interest expense	13	11,762,797	8,338,283
Depreciation and amortization	19	3,604,040	2,062,379
Provision for expected credit losses	7	2,712,830	12,822,027
Provision for retirement benefits	19, 21	290,984	388,385
Gain on sale of investment properties	19	(958,120)	(3,661,467)
Operating income before working capital changes		28,486,819	29,572,502
Changes in operating asset and liabilities:			
Increase in loans and receivables	7	(42,043,905)	(14,256,689)
Decrease (increase) in other assets	12	2,977,442	(4,348,795)
Decrease in deposit liabilities	13	(14,770,219)	(5,243,204)
Increase (decrease) in accrued interest and other expenses	15	730,254	(1,386,599)
Increase (decrease) in other liabilities	16	(461,304)	761,925
Cash generated from (used in) operations		(25,080,933)	5,099,140
Interest paid		(10,093,390)	(8,278,920)
Income taxes paid		(5,812,570)	(5,727,487)
Net cash used in operating activities		(40,986,883)	(8,907,267)
CASH FLOWS FROM INVESTING ACTIVITIES			
Net proceeds from sale of investment properties		2,269,911	6,327,500
Additions to intangible asset	11	(135,000)	(499,960)
Net additions to bank premises, furniture, fixtures and equipment	10	(3,438,114)	(421,210)
Contributions to retirement fund	21	(707,021)	(788,968)
Proceeds from redemption of unquoted debt securities classified as		-	732,915
Net cash provided by (used in) investing activities		(2,010,224)	5,350,277
CASH FLOWS FROM FINANCING ACTIVITIES			
Availment of bills payable		112,576,720	63,964,787
Payments of bills payable		(69,659,701)	(52,648,515)
Net cash provided by financing activities		42,917,019	11,316,272
NET INCREASE IN CASH AND CASH EQUIVALENTS		(80,088)	7,759,282
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
Cash and other cash items		5,488,172	5,114,432
Due from Bangko Sentral ng Pilipinas		8,535,382	8,617,391
Due from other banks		52,573,036	45,105,485
		66,596,590	58,837,308
CASH AND CASH EQUIVALENTS AT END OF YEAR			
Cash and other cash items		7,071,057	5,488,172
Due from Bangko Sentral ng Pilipinas		9,748,344	8,535,382
Due from other banks		49,697,101	52,573,036
		₱ 66,516,502	₱ 66,596,590

See accompanying Notes to Financial Statements.

SOUTH BANK (A RURAL BANK) INCORPORATED
NOTES TO FINANCIAL STATEMENTS

1. General

South Bank (A Rural Bank) Incorporated is organized under the laws and regulations governing the establishments and operations of rural banks in the Philippines under Republic Act (R.A.) No. 720, as amended by R.A. No. 7353 (Rural Bank Act of 1992). Its primary purpose is to carry out and engage in the business of extending rural credit to small farmers and tenants and to deserving rural industries and enterprises, to have and exercise all authority and powers, to do and perform acts, and to transact all businesses which may be legally had or done by rural banks organized under the aforementioned Act and to do all other things incident thereto and necessary and proper in connection with the said purpose which such territory, as may be determined by the Monetary Board of the Bangko Sentral ng Pilipinas (BSP).

The certificate of incorporation of the Bank was issued by the Securities and Exchange Commission (SEC) on November 23, 1993 and shall expire on November 23, 2043.

The registered address of the Bank's head office is at Rodelsa Hall, R.N. Pelaez Boulevard, Kauswagan, Cagayan de Oro City. The Bank has seven (7) branches located in Kitaotao, Libona, and Valencia in Bukidnon, in Cogon and Velez in Cagayan de Oro City, and in Butuan in Caraga Region.

The branch in Butuan started commercial operations on June 5, 2018 using the license to operate of the closed branch in Bulua. All accounts of Bulua branch were merged with the Velez branch on April 26, 2018.

2. Summary of Significant Accounting Policies

<u>Basis of Financial Statement Preparation</u>
The accompanying financial statements have been presented in Philippine peso and prepared using the historical cost basis, except for financial instruments carried at fair value. Historical cost is the fair value of the consideration given in exchange for assets.

Fair value is the price that will be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date.

<u>Statement of Compliance</u>
The accompanying financial statements of the Bank have been prepared in conformity with the Financial Reporting Standards in the Philippines (FRSP) for banks which are substantially the same with the Philippine Financial Reporting Standards (PFRS).

PFRSs are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board (IASB).

The financial statements have been prepared using the measurement bases specified by the PFRS for each type of resources, liabilities, income and expenses. The measurement bases are more fully described in the accounting policies as follows.

Management's Assumptions, Estimates and Judgments

The preparation of the financial statements in conformity with PFRS requires Management to make assumptions, estimates and judgments that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both the current and future periods.

Adoption of New and Revised Accounting Standards, Amendments to Standards and Interpretations

The accounting policies adopted are consistent with those of prior periods' adoptions, except for the following new standards, amendments to the standards and interpretation effective January 1, 2018:

- PFRS 2, *Amendment – Classification and Measurement of Share-based Payment Transactions,* clarifies that the accounting for the effects of vesting and non-vesting conditions should follow the same approach as for equity-settled share-based payments.

- PFRS 4, *Amendment – Insurance contracts: Applying PFRS 9, Financial Instruments,* provides two options for entities that issue insurance contracts, the option to recognize in other comprehensive income rather than profit or loss, the volatility that could arise when PFRS 9 is applied before the new insurance contracts standard is issued; and give companies whose activities are predominantly connected with insurance an optional temporary exemption from applying PFRS 9 until 2021.

- PFRS 7, *Amendment – Financial Instruments: Disclosures – Mandatory Effective Date and Transition Disclosures*, amended together with PFRS 9 which is effective for annual periods beginning on or after January 1, 2015 or otherwise when PFRS 9 is first applied.

- PFRS 9, *Financial Instruments*, which supersedes PAS 39, *Financial Instruments: Recognition and Measurement*, introduces the classification and measurement of financial instruments, impairment methodology and hedge accounting. These amendments comprise of reduction from four (4) measurement categories into two (2) categories, i.e. fair value and amortized cost, and from several impairment methods into one (1) method, i.e. expected credit loss model.

- PFRS 15, *Revenue from Contracts with Customers,* which will supersede PAS 18, *Revenue*, which specifies how and when an entity recognize revenue as well as requiring such entities to provide users of financial statements with more informative and relevant disclosures. The standard provides a comprehensive single, principles-based five-step model to be applied to all contracts with customers.

- Amendment to PAS 40, *Amendment – Investment Property,* amends the requirements on when an entity should transfer a property asset to, or from, investment property. A transfer is made when and only when there is an actual change in use. A change in management intention alone does not support a transfer.

- IFRIC 22, *Foreign Currency Transactions and Advance Consideration,* clarifies the accounting for transactions that include the receipt of payment of advance consideration in a foreign currency.

Annual improvements to PFRS (2014-2016 Cycle) made amendment to a number of PFRS which are relevant to the Bank:

- PFRS 1, *Amendment – First-time Adoption of Philippine Financial Reporting Standards,* which deleted the short-term exemptions for the first-time adopters.

- PAS 28, *Amendment – Long-term Interests in Associates and Joint Ventures,* clarifies that an entity applies PFRS 9, *Financial Instruments,* including its impairment requirements to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.

The adoption of the aforementioned amendments has no material impact on the Bank's financial position and results of operations and did not result in the restatement of prior year financial statements except for the reclassifications made on financial assets in accordance with PFRS 9. This may, however, affect the accounting for future transactions or arrangements.

<u>Future changes in Accounting Policies</u>
The Bank will adopt the following amendments to PAS, improvements to PFRS and interpretation that are relevant to the Bank:

Effective for annual periods beginning on or after January 1, 2019

- PFRS 16, *Leases,* which provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements.

- PAS 28, *Investment Associates and Joint Ventures*, clarifies that the election to measure at fair value through profit or loss of investment in an associate or a joint venture that is held by an entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

- Philippine Interpretation IFRIC-23, *Uncertainty over Income Tax Treatments*, clarifies how to apply the recognition and measurement requirements in PAS 12 *Income Taxes* when there is uncertainty over income tax treatments.

  Under the interpretation, whether the amounts recorded in the financial statements will differ to that in the tax return, and whether the uncertainty is disclosed or reflected in the measurement, depends on whether it is probable that the tax authority will accept the Bank's chosen tax treatment.

Effective for annual periods beginning on or after January 1, 2021

- PFRS 17, *Insurance Contracts*, which will supersede PFRS 4, provides guidance for the recognition, measurement, and disclosure of Insurance Contracts.

Management is yet to assess the impact that the foregoing amendment, new standards and interpretation are likely to have on the financial statements of the Bank.

The Bank deferred the adoption of PFRS *Practice Statement on Management Commentary,* which provides a broad, non-binding framework for the presentation of management commentary that relates to financial statements that have been prepared in accordance with PFRS.

The Bank could not yet determine the impact of the practice statement on its financial statements. The Bank, however, does not expect material impact on its financial statements when it adopts the aforementioned practice statement.

Foreign Currency Transactions

Transactions in foreign currencies are recorded using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated using the closing exchange rate at the end of the reporting period. Foreign exchange gains and losses arising from subsequent settlement or restatement of monetary assets and liabilities are included in the statement of comprehensive income.

Cash and Cash Equivalents

Cash and cash equivalents include cash and other cash items, and amounts due from BSP and other banks with maturities of three (3) months or less from dates of placements. Cash is unrestricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three (3) months or less and that are subject to an insignificant risk of change in value. Cash and cash equivalents are valued at face value.

Financial Assets and Financial Liabilities

Financial assets include cash and other cash items, due from BSP and other banks, loans and receivables, unquoted debt securities classified as loans, pension asset and other assets. Financial liabilities include deposit liabilities, bills payable, accrued interest and other expenses, accrued retirement and other liabilities.

Date of recognition

The Bank recognizes a financial asset or a financial liability when it becomes a party to the contractual provisions of the instrument. All regular way purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace, the financial asset is recognized on the trade date or settlement date.

Initial measurement
Financial assets and financial liabilities are recognized initially at fair value, which is the fair value of the consideration given (asset) or received (liability). Except for investments at fair value through profit and loss (FVTPL), the initial measurement of instruments includes transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs that are directly attributable to the acquisition of investments at FVTPL are recognized immediately in profit or loss. Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties.

The Bank classifies its financial assets in the following categories: investments at FVTPL, investments at FVTOCI, and investments at amortized cost.

The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classifications of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

All equity investments in the scope of PFRS 9 are to be measured at fair value in the statement of financial position, with value changes recognized in profit or loss, except for those equity investments for which the Bank has elected to present value changes in other comprehensive income. There is no cost exception for unquoted equities.

The classification depends on the following:

- The business model of the entity whose objective is achieved by collecting contractual cash flows or selling financial assets or both; and

- The contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Portfolio Exception
If the Bank manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risks, the Bank is permitted to apply an exception to this PFRS for measuring fair value.

That exception permits the Bank to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, the Bank shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

Fair Value Hierarchy
Financial assets and financial liabilities are categorized in accordance with the fair value hierarchy. This hierarchy groups financial assets and financial liabilities into three (3) levels as follows:

- *Level 1*: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- *Level 2*: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- *Level 3*: inputs for the asset or liability that are not based on observable market data.

As of December 31, 2018 and 2017, the Bank has no financial instruments valued based on Levels 1, 2 and 3.

Effective interest method
It is a method of calculating the amortized cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or, where appropriate, a shorter period, to the amortzed cost at initial recognition. When calculating the effective interest rate, the Bank estimates the expected cash flows by considering all the contractual terms of the financial instrument excluding the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably.

However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the Bank shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Income is recognized on an effective interest basis for debt instruments other than those financial assets classified as at FVTPL and FVTOCI.

Due from BSP and other banks
Due from BSP represents the amounts that are placed as reserved deposits with the BSP in lieu of government securities holding to be bought directly from BSP.

Due from other banks represents the balances of deposit accounts maintained with other resident banks excluding loans and advances.

Due from BSP and other banks are carried at face value, which approximates fair value, less any impairment in value.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as financial assets at FVTOCI or financial asset at FVTPL.

These arise when the Bank provides money, goods or services directly to the debtor with no intention of trading the receivables. Included in this category are financial assets arising from direct loans to customers, interbank loans receivables, sales contract receivables and all receivables from customer and other banks.

Loans and receivables are subsequently carried at amortized cost using effective interest method, reduced by unearned interest and discounts and allowance for expected credit losses.

Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through amortization process, except for reclassified financial assets under PFRS 9 and PFRS 7. Increases in estimates of future cash receipts from financial assets that have been reclassified in accordance with PFRS 9 and PFRS 7 shall be recognized as an adjustment to the effective interest rate from the date of the change in estimate. Purchases of securities under reverse repurchase agreements of substantially identical securities with the BSP are included in this category. The difference between the sale and repurchase price is recognized as interest and accrued over the life of the agreements using the straight-line method.

Impairment loss is the estimated amount of loss in the Bank's loan portfolio, based on the evaluation of the estimated future cash flows discounted at the loan's original effective interest rate or the last re-pricing rate for loans issued at variable rates. Impairment is established through an allowance account which is charged to expense. Loans and receivables are written off against the allowance for impairment when the Management believes that the collectability of the principal is unlikely, subject to BSP regulations.

Under existing BSP regulations, non-accruing loans, refer to loan accounts whose principal and/or interest is unpaid for 30 days or more after due date or after these accounts become past due and included as items in litigation. Interest income on these accounts is recognized only to the extent of cash collections received. Loans are not reclassified as accruing until interest and principal payments are brought current or the loans are restructured in accordance with existing BSP regulations, and future payments appear assured.

Section 304 of December 31, 2017 Manual of Regulations for Banks defines accounts considered as past due. As a general rule, loans, investments, receivables, or any financial asset, including restructured loans, shall be considered past due when any principal and/or interest or installment due, or portions thereof, are not paid at their contractual due date, in which case, the total outstanding balance thereof shall be considered as past due. However, the Bank may provide a cure period on a credit product-specific basis, not to exceed thirty (30) days within which to allow the obligors or borrowers to catch up on their late payment without being considered as past due provided that:

- any cure period policy shall be based on verifiable collection experience and reasonable judgment that support tolerance of occasional payment delays;

- the observance of a cure period policy shall not preclude the timely adverse classification of an account that has developed a material credit weakness; and

- that the Bank shall regularly review the reasonableness of its cure period policy.

Further, for microfinance and other small loans that feature high frequency payments, the cure period allowable by policy shall not exceed ten (10) days.

Allowance for expected credit losses on loans and receivables are set in accordance with BSP's existing guidelines on loan provisioning. (Refer also to Allowance for Expected Credit Losses policy).

Financial assets at FVTPL
Financial assets at FVTPL include financial assets held for trading purposes, financial assets designated upon initial recognition as at FVTPL, and derivative instruments.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling or repurchasing it in the near term;

- on initial recognition, it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

- it is a derivative that is not a financial guarantee contract or a designated and effective as a hedging instrument.

Financial assets classified in this category are designated by Management on initial recognition when the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis; or

- The assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

After initial recognition, investments at FVTPL are measured at fair value except for investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost.

Changes in the fair value and interest components are taken directly to the statement of comprehensive income for the year.

Financial assets (except derivatives, equity investments and debt investment measured at FVTPL by irrevocable election) may be subsequently reclassified out of FVTPL, when the financial asset is reclassified from FVTPL to amortized cost, the fair value at the reclassification date becomes the new carrying amount. The difference between the new carrying amount of the financial asset at amortized cost and the face value of the financial asset shall be amortized through profit or loss over the remaining life of the financial asset using the effective interest method. An effective interest rate must be determined based on the new carrying amount or fair value at reclassification date.

When reclassifying the financial asset from FVTPL to FVTOCI, the financial asset continues to be measured at fair value. The fair value at the reclassification date becomes the new carrying amount. An effective interest rate must be determined based on the new carrying amount or fair value at the reclassification date.

The Bank does not have any financial asset or financial liability at FVTPL as of December 31, 2018 and 2017.

Financial Assets at Amortized Cost
Financial assets at amortized cost are non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Bank has the positive intention and ability to hold to maturity. Investments which include equity instruments intended to be held for an unidentified period are not included in this classification.

These financial assets are measured at amortized cost if both the conditions are met:

- The business model is to hold the financial asset in order to collect contractual cash flows on specified date; and

- The contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

After initial measurement, investments at amortized cost are measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium through periodic amortization charges or credits to income. When the decline in fair value below the amortized cost is other than temporary, i.e., full collection of principal and interest is not expected on the investments, the amortized cost basis of the particular financial asset shall be adequately provided with allowance for expected credit losses. Gains and losses arising from the changes in fair value are included in the statement of comprehensive income.

When the Bank shall reclassify a financial asset from amortized cost to fair value through profit or loss, the fair value is determined at reclassification date. The difference between the previous carrying amount and fair value is recognized in profit or loss.

The Bank's loans and receivables and unquoted debt securities classified as loans are included in this category.

Financial Assets at FVTOCI
These are non-derivative financial assets that are designated in this category or are not classified in any other categories. Subsequent to initial recognition, financial assets at FVTOCI are carried at fair value. However, if insufficient more recent information of equity instruments irrevocably elected at FVOTCI is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range then cost may be the appropriate estimate of fair value.

Changes in the fair value of such assets are reported in other comprehensive income and accumulated in equity section of the statement of financial position until the investment is derecognized or the investment is determined to be impaired.

These financial assets are measured at FVTOCI if both the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and by selling the financial assets; and

- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

When the Bank reclassifies financial assets at FVTOCI to amortized cost, the fair value at reclassification date becomes the amortized cost carrying amount. The cumulative gain or loss previously recognized in other comprehensive income is eliminated and adjusted against the fair value at reclassification date. The original effective rate is not adjusted.

Further, if the Bank reclassifies the financial assets at FVTOCI to FVTPL, the financial assets continue to be measured at fair value. The fair value at reclassification date becomes the new carrying amount. The cumulative gain or loss previously recognized in other comprehensive income is reclassified to profit or loss at reclassification date.

On derecognition or impairment, the cumulative gain or loss previously accumulated in the equity section is reclassified to the statement of comprehensive income except for equity instruments irrevocably elected at FVTOCI which shall not be subsequently transferred to the statement of comprehensive income. However, the Bank may transfer the cumulative gain or loss within equity.

Reversal of impairment losses is recognized in other comprehensive income, except for financial assets that are debt securities which are recognized in profit or loss only if the reversal can be objectively related to an event occurring after the impairment loss was recognized.

Interest earned on holding the investments at FVTOCI is recognized in the statement of comprehensive income using the effective interest method.

The Bank does not have any investments at FVTOCI as of December 31, 2018 and 2017.

Unquoted debt securities classified as loans
These are debt securities issued by the government generally consisting of bonds, treasury bills/notes and certificates of indebtedness issued by the Philippine Government, its political subdivisions and instrumentalities and/or corporations owned and/or controlled by the government, with fixed or determinable payments that are not quoted in an active market. These bonds and other debt instruments may form part of the Bank's reserve against deposit substitutes.

After initial recognition, these are measured at their amortized cost using the effective interest method. A gain or loss arising from the change in the fair value is recognized in the statement of comprehensive income when the security is derecognized or impaired, and through the amortization process.

The Bank has unquoted debt securities classified as loans amounting to ₱ 1,950,056 as of December 31, 2018 and 2017 (Note 8).

Sales contract receivables
Sales contract receivables (SCR) are recorded based on the present value of the installment receivables discounted at the imputed rate of interest. Discount is accreted over the life of the SCR by crediting interest income using the effective interest method. Any difference between the present value of the SCR and the derecognized assets are recognized in profit or loss at the date of sale in accordance with the provisions of PFRS 5, *Revenue from Customers*, provided, furthermore, that SCR shall be subject to impairment provision of PFRS 9, *Financial Instruments.*

The Bank has sales contract receivable amounting to ₱ 2,493,943 and ₱ 2,206,163 as of December 31, 2018 and 2017, respectively (Note 7).

Financial assets carried at cost
These are investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and the derivatives that are linked to must be settled by delivery of such unquoted equity instruments. These investments are measured at cost.

If there is an objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment shall not be reversed.

The Bank does not have an investment in ordinary share as of December 31, 2018 and 2017.

Financial liabilities at FVTPL
Financial liabilities are classified in this category if these result from trading activities or derivative transactions that are not accounted for as accounting hedges, or when the Bank elects to designate a financial liability under this category. These are remeasured at fair value, with gains or losses recognized in profit or loss.

The Bank has no designated financial liability at FVTPL as of December 31, 2018 and 2017.

Other financial liabilities
This category pertains to financial liabilities that are not held for trading or not designated as at FVTPL upon the inception of the liability. These include liabilities arising from operations or borrowings. Other financial liabilities are subsequently measured at amortized cost using effective interest method.

The Bank's deposit liabilities, accrued interest and other expenses, accrued retirement liability and other liabilities are included in this category.

Financial guarantee contracts
A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument.

Financial guarantee contracts issued by a group entity are initially measured at their fair values and, if not designated as FVTPL, are subsequently measured at a higher of:

- The amount of the obligation under the contract, as determined in accordance with PAS 37; and
- The amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Deposit liabilities
Deposit liabilities are recognized initially at fair value and subsequently measured at amortized cost less settlement payment.

The Bank's deposit liabilities amounted to ₱ 234,320,737 and ₱ 249,090,956 as of December 31, 2018 and 2017, respectively (Note 13).

Bills payable and other borrowed funds
Issued financial instruments or their components, which are not designated at FVTPL, are classified as liabilities under "Bills payable" or other appropriate financial liability accounts, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

Bills payable are initially recognized at fair value equivalent to the issue proceeds (fair value of the consideration received), net of direct issue costs.

The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole amount separately determined as fair value of the liability component on the date of issue.

After initial measurement, bills payable and similar financial liabilities not qualified as and not designated as FVTPL are measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the effective interest rate.

The Bank has bills payable outstanding amounting to ₱ 100,003,539 and ₱ 57,086,520 as of December 31, 2018 and 2017, respectively (Note 14).

Accrued interest and other expenses, and other liabilities
Accrued interest and other expenses, and other liabilities are obligations to pay for the goods and services provided to the Bank. These are recognized initially at their nominal value and are subsequently measured in amounts which they are paid.

The Bank has accrued interest and other expenses of ₱ 5,760,781 and ₱ 3,361,120 (Note 15) and other liabilities of ₱ 2,599,874 and ₱ 2,809,910 as of December 31, 2018 and 2017, respectively (Note 16).

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

- The rights to receive cash flows from the asset have expired or have been settled; or

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

- The Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset or (b) has neither transferred nor retained the risks and rewards of the asset but has transferred the control of the asset.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when the Bank retains an option to repurchase part of a transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the Bank retains control), the Bank allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognized on the basis of the relative fair values of those parts on the date of the transfer.

The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Derecognition of financial liabilities
A financial liability is derecognized when the obligation under the liability is discharged or canceled or has expired. Where an existing liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

Impairment of financial assets
Financial assets, other than those at FVTPL and FVTOCI, are assessed based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been re-priced to reflect an increase in credit risk) instead of an evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring.

The Bank shall recognize a loss allowance for expected credit losses on a financial asset that is measured equal to the 12-month expected credit losses or the full lifetime expected credit losses if the credit risk of that financial instrument has increased significantly since initial recognition, as well as to contract assets or trade receivables that do not constitute a financing transaction in accordance with PFRS 15.

Credit losses are the present value of all cash shortfalls. Expected credit losses are an estimate of credit losses over the life of the financial instrument.

When measuring expected credit losses, the Bank considers the following:

- The probability-weighted outcome, wherein the estimate should reflect the possibility that a credit occurs and the possibility that no credit loss occurs.

- The time value of money, wherein the expected credit losses should be discounted.

- Reasonable and supportable information that is available without undue cost or effort.

The Bank uses various sources of data both internal or entity-specific and external in measuring expected credit losses.

For FVTOCI equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or

- breach of contract, such as a default or delinquency in interest or principal payments; or
- it becomes probable that the borrower will enter bankruptcy or financial re-organization; or
- the disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, such as loans and receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Bank's past experience of collecting payments, an increase in the number of past due loans and receivables, as well as observable changes in national or local economic conditions that correlate with default on loans and receivables.

If there is any objective evidence that an impairment loss has been incurred, the amount of the loss is measured as follows:

<u>Financial assets carried at amortized cost</u>
The amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of loss shall be recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

<u>Financial assets carried at cost</u>
The amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans and receivables, where the carrying amount is reduced through the use of an allowance account. When a receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

<u>Financial Assets at FVTOCI</u>
The cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period the FVTOCI financial asset is derecognized.

In respect of FVTOCI equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss rather only reclassification of equity is permitted.

Any increase in fair value subsequent to an impairment loss is recognized in other comprehensive income and accumulated under equity. In respect of FVTOCI debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

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

Hedge Accounting
Derivatives may be designated as a hedging instrument provided that the following conditions are met:

- At the inception of the hedge, there must be a formal designation and documentation of hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. The documentation shall include identification of the hedging instrument, the hedge item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.

- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.

- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.

- The effectiveness of the hedge can be reliably measured.

- The hedge is asserted on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

Fair value hedge
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognized in profit or loss or other comprehensive income, if the hedging instrument hedges an equity instrument for which the Bank has elected to present changes in fair value in other comprehensive income immediately. The hedging gain or loss on the hedged item shall be adjusted to the carrying amount of the hedged item (if applicable) and be recognized in profit or loss.

If the hedged item is a financial asset (or a component thereof) that is measured at fair value through other comprehensive income, the hedging gain or loss on the hedged item shall be recognized in the profit or loss.

However, if the hedged item is an equity instrument for which the Bank has elected to present changes in fair value in other comprehensive income, those amounts shall remain in other comprehensive income. When hedged item is an unrecognized firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognized as an asset or a liability with a corresponding gain or loss recognized in profit or loss.

When a hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire an asset or assume a liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognized in the statement of financial position.

Any adjustment arising from the change in fair value shall be amortized to profit or loss if the hedged item is a financial instrument (or a component thereof) measured at amortized cost. Amortization may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses.

The amortization is based on a recalculated effective interest rate at the date that amortization begins. In the case of a financial asset (or a component thereof), that is a hedged item and that is measured at fair value through other comprehensive income, amortization applies in the same manner but to the amount that represents the cumulative gain or loss previously recognized instead of by adjusting the carrying amount.

Cash flow hedge
Cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability and could affect profit or loss.

The hedge is accounted for as follows:

a. the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following:

    - the cumulative gain or loss on the hedging instrument from the inception of the hedge; and

    - the cumulative change in fair value (present value) of the hedged item (i.e. the present value of the cumulative change in the hedged expected future cash flows) from the inception of the hedge.

b. the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (i.e. the portion that is offset by the change in the cash flow hedge reserve calculated shall be recognized in other comprehensive income.

c. any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated is hedge ineffectiveness that shall be recognized in profit or loss.

d. the amount that has been accumulated in the cash flow hedge reserve shall be accounted for as shown on the next page:

- if a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the Bank shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment and hence it does not affect other comprehensive income.

- for cash flow hedges other than those covered by (1), that amount shall be reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment in the same period or periods during which the hedged expected future cash flows affect profit or loss.

- however, if that amount is a loss and the Bank expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment.

When the Bank discontinues hedge accounting for a cash flow hedge it shall account for the amount that has been accumulated in the cash flow hedge reserve as follows:

- if the hedged future cash flows are still expected to occur, that amount shall remain in the cash flow hedge reserve until the future cash flows occur or apply.

- if the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

Hedge of a net investment in foreign operations
Hedge is accounted for similarly to cash flow hedges. The gain or loss on the hedging instrument relating to the ineffective portion of the hedge that has been recognized in other comprehensive income shall be reclassified from equity to profit or loss as a reclassification adjustment on the disposal or partial disposal of the foreign operation.

The Bank has no hedging instruments or hedged items in neither domestic nor foreign operations in both years.

<u>Derivatives</u>
Derivatives are initially recognized at fair value on the date in which the derivative transaction is entered into or bifurcated, and are subsequently remeasured at fair value at the end of the reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event, the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Derivatives are carried as an asset when the fair value is positive and as a liability when the fair value is negative.

The Bank has no derivative transactions, such as foreign exchange forward contracts, interest rate swaps and cross-currency swaps as of December 31, 2018 and 2017.

Embedded Derivatives
An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

- The hybrid or combined instrument is not recognized at FVTPL.

The Bank has no transactions with embedded derivatives as of December 31, 2018 and 2017.

Allowance for Expected Credit Losses
Allowance for expected credit losses is maintained at a level considered adequate to provide for potential losses on receivables and other resources. The allowance is increased by provisions charged to expense and reduced by net write-offs and reversals.

The level of allowance is based on the Management's evaluation of potential losses after consideration of the prevailing and anticipated economic conditions, the evaluation of potential losses based on existing guidelines of the BSP and the Management's judgment as to identifiable losses on specific accounts based on past collection experience, collateral position and account documentation. The BSP requires banks to observe certain criteria and guidelines based largely on the classification of loans in establishing the allowance for expected credit losses. Loans and receivables are written-off against the allowance for expected credit losses when Management is satisfied that such accounts are worthless.

Loans and other credit accommodations with unpaid principal and/or interest shall be classified and provided with allowance for expected credit losses (AECL) based on the number of days of missed payments as shown on below:

For unsecured loans and other credit accommodations:

Number of days unpaid/ with missed payment	Classification	AECL
31 - 90 days	Substandard	10%
91 - 120 days	Substandard	25%
121 - 180 days	Doubtful	50%
181 days and over	Loss	100%

For secured loans and other credit accommodations:

Number of days unpaid/ with missed payment	Classification	AECL
31 - 180 days*	Substandard	10%
181 - 365 days	Substandard	25%
Over 1 year - 5 years	Doubtful	50%
Over 5 years	Loss	100%

*When there is imminent possibility of foreclosure and expectation of loss, AECL shall be increased to 25%.

Provided, that where the quality of physical collaterals or financial guarantees securing the loans and advances are determined to be insufficient, weak or without recoverable values, such loans and advances shall be treated as if these are unsecured.

For accounts receivable other than loans and receivables that have been outstanding for more than 360 days are provided with 100% allowance for expected credit losses.

Specific allowance for probable losses on microfinance loans shall be set up immediately in accordance with the Performance at Risk (PAR) number of days of missed payment as shown below:

No. of days of missed payment	Classification	AECL
PAR 1 – 30	Especially mentioned	2%
31 – 60 and/or loans restructured once	Substandard	25%
61 – 90	Doubtful	50%
91 or more and/or loans restructured twice	Loss	100%

Provided, that a general provision for losses for microfinance loans equivalent to one (1) percent of the outstanding balance of microfinance loans not subject to the foregoing provisioning less microfinance loans which are considered non-risk under existing laws/rules/regulations, if any, shall be set up.

Investment Properties

Investment properties pertain to land and buildings held to earn rentals and/or for capital appreciation (including property under construction for such purposes).

These are initially measured at cost, including transaction costs, and subsequently carried at cost less accumulated depreciation and any impairment in value. Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

Investment properties also include real and other properties acquired (ROPA) or those land and buildings acquired by the Bank from defaulting borrowers. For these assets, cost is recognized at fair value of the investment property unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset was given up is reliably measured.

The difference between the fair value of the asset received and the carrying amount of the loan settled through foreclosure of investment property is recognized as gain on foreclosure of investment properties in the statement of comprehensive income.

Appraisal of properties is conducted by independent firm of appraisers and internal appraisers of the Bank to determine if the Bank's investment properties are impaired.

An investment property is derecognized upon disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising from the derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

Real and Other Properties Acquired (ROPA)
ROPA in settlement of loans through foreclosure or dation in payment is recognized upon:

- Entry of judgment in case of judicial foreclosure;
- Execution of the Sheriff's Certificate of Sale in case of extrajudicial foreclosure; and
- Notarization of the Deed of Dacion in case of dation in payment (dacion en pago).

These are recorded initially at the carrying amount of the loan (i.e., outstanding loan balance adjusted for any unamortized premium or discount less allowance for probable losses computed based on PFRS 9 provisioning requirements) plus recorded accrued interest less allowance for probable losses plus transaction costs incurred upon acquisition (such as non-refundable capital gains tax and documentary stamp tax paid in connection with the foreclosure/purchase of the acquired real estate property).

Provided, that when the booked amount of ROPA exceeds the appraised value of the acquired property, an allowance for probable losses equivalent to the excess of the amount booked over the appraised value shall be set up. Provided, further, that if the carrying amount of ROPA exceeds ₱ 5 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP.

The carrying amount of ROPA is allocated to land, building, other non-financial assets and financial assets (e.g. receivable from third party or equity interest in an entity) based on their fair values, which the allocated carrying amounts become their initial costs.

Subsequently, ROPA is accounted for as follows:

a. Land and buildings shall be accounted for using the cost model under PAS 40, *Investment Property;*
b. Other non-financial assets shall be accounted for using the cost model under PAS 16, *Property, Plant and Equipment*;
c. Land, buildings and other non-financial assets shall be subjected to the impairment provisions of PAS 36, *Impairment of Assets*;
d. Financial assets shall be initially booked and classified according to intention (i.e., FVTPL, FVTOCI, at Amortized Cost, Unquoted Debt Securities Classified as Loans or Loans and Receivable) and accounted for in accordance with the provisions of PFRS 9, *Financial Instruments: Recognition and Measurement*; and

e. ROPAs that comply with the provisions of PFRS 5, *Non-Current Assets Held for Sale*, shall be reclassified and accounted for as such.

BSP requires that claims arising from deficiency judgments rendered in connection with the foreclosure of mortgaged properties shall be lodged under the real account "Deficiency Judgment Receivable" while probable claims against the borrower arising from the foreclosure of mortgaged properties shall be lodged under the contingent account "Deficiency Claims Receivable".

Before foreclosing or acquiring any property in settlement of loans, it must be properly appraised to determine its true economic value. An in-house appraisal of all ROPAs is made at least every other year: provided, that immediate re-appraisal is conducted on ROPAs which materially decline in value.

Financial institutions that accept non-cash payments for interest on their borrowers' loans shall book the acquired assets as ROPA. The amount booked as ROPA is equal to accrued interest less allowance for probable losses; provided, that where the booked amount of ROPA exceeds the appraised value of the acquired property, an allowance for probable losses equivalent to the excess of the amount booked over the appraised value shall be set up. The carrying amount of ROPA is allocated in accordance with the BSP Circular 494, item (c) 2 and subsequently accounted for in accordance with item (c) 3 of the same Circular.

The Bank has recognized ROPA accounted for as investment properties amounting to ₱ 7,615,397 and ₱ 4,962,299 as of December 31, 2018 and 2017, respectively (Note 9).

Intangible Assets

Intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses. Internally-generated intangible assets are expensed as incurred.

An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognized if, and only if, all of the following have been demonstrated:

- Technical feasibility of completing the intangible asset so that it will be available for use or sale;
- Intention to complete the intangible asset and use or sell it;
- Ability to use or sell the intangible asset;
- How the intangible asset will generate probable future economic benefits;
- Availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- Ability to measure reliably the expenditure attributable to the intangible asset during its development;

The useful lives of the intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is indication that the intangible asset may be impaired.

The amortization period and amortization method are reviewed at every financial year end. Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level. Such intangibles are not amortized.

The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in useful life assessment from indefinite to finite is made prospectively.

The Bank has intangible asset amounting to ₱ 873,001 and ₱ 2,120,591 as of December 31, 2018 and 2017, respectively (Note 11).

Bank Premises, Furniture, Fixtures and Equipment

Bank premises, furniture, fixtures and equipment are initially measured at cost and subsequently carried at cost less accumulated depreciation and any accumulated impairment losses. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss resulting from disposal is included in the statement of comprehensive income. Each item of bank premises, furniture, fixtures and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

The initial cost of bank premises, furniture, fixtures and equipment consists of its purchase price including import duties, non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Directly attributable cost can include the following:

- Costs of employee benefits (as defined in PAS 19, *Employee Benefits (Revised)*) arising directly from the construction or acquisition of the item of bank premises, furniture, fixture and equipment;
- Cost of site preparation;
- Initial delivery and handling;
- Installation and assembly;
- Cost of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition; and
- Professional fees.

The costs below are not costs of an item of bank premises, furniture, fixture and equipment rather recognized as an expense when they are incurred:

- Cost of opening a new facility;
- Cost of introducing a new product or service (including costs of advertising and promotional activities);
- Cost of conducting business in a new location or with a new class of customer (including costs of staff training); and
- Administration and other general overhead costs.

Expenditures incurred after the bank premises, furniture, fixtures and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the period in which the costs are incurred.

In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of bank premises, furniture, fixtures and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of bank premises, furniture, fixtures and equipment.

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

Leasehold and improvements	10 years
Information technology equipment	3 years
Office equipment	3 years
Furniture and fixtures	3-5 years
Transportation equipment	5 years

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

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.

If there is an indication that there has been a significant change since the last annual reporting date in the pattern by which an entity expects to consume an asset’s future economic benefits, the Bank shall review its present depreciation method and, if current expectations differ, change the depreciation method to reflect the new pattern. The Bank shall account for the change as a change in an accounting estimate.

Factors such as a change in how an asset is used, significant unexpected wear and tear, technological advancement, and changes in market prices may indicate that the residual value or useful life of an asset has changed since the most recent annual reporting date.

If such indicators are present, an entity shall review its previous estimates and, if current expectations differ, amend the residual value, depreciation method or useful life. The Bank shall account for the change in residual value, depreciation method or useful life as a change in an accounting estimate.

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

An item of bank premises, furniture, fixtures and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising from the disposal or retirement of an item of bank premises, furniture, fixtures and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

Construction in Progress

Costs incurred during the period that are directly attributable to the ongoing construction of building are capitalized as construction in progress which shall be reported as part of property and equipment. The asset shall not be depreciated until it is classified as owner-occupied property.

Property under construction or development for future use as an investment property is classified and accounted for under investment property.

Non-current Assets Held for Sale

Non-current assets held for sale include ROPAs in which the carrying amounts will be recovered principally through a sale transaction rather than through continuing use. These assets are available for immediate sale in its present condition and completion of the sale is expected within one (1) year from the date of classification. Non-current assets held for sale are measured at the lower of its carrying amount or fair value less cost to sell. These assets are not depreciated but subject to impairment in value.

Borrowing Costs

Borrowing costs are recognized on the basis of effective interest method and are included in finance costs. These are directly expensed in profit or loss in the period in which these are incurred except those that are directly attributable to the construction of buildings 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, which are being capitalized during the period of construction or production. Capitalization ceases when the construction or production are substantially complete.

For income tax purposes, borrowing costs are treated as deductible expenses during the period such were incurred.

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

Impairment of Non-Financial Assets

The carrying values of investment properties, bank premises, furniture, fixtures and equipment are reviewed at the end of each reporting period to determine whether there is any indication of impairment. If any such indication exists, the asset’s recoverable amount is estimated in order to determine the extent of impairment, if any.

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

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

The recoverable amount is the greater of the asset’s fair value less cost to sell and value in use. Fair value less cost to sell is the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties less cost of disposal.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

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

Related Parties

Related parties include entities and individuals that directly or indirectly, through one or more intermediaries, control or are controlled by or under common control with the Bank, including holding companies, subsidiaries and fellow subsidiaries. Persons or close members of the families of these persons are also related parties if these persons have significant influence over the Bank or they are members of the key management personnel, including directors and officers of the Bank. Post-employment defined benefit plan for the benefit of employees of either the Bank or an entity related to the Bank is also considered as a related party. The Bank takes into consideration the substance of the relationship of the related party over its legal form.

Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate of the amount required to settle the obligation. The provision shall be reversed if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be reliably measured. The amount recognized for the reimbursement shall not excedd the amount of the provision.

Contingencies

Contingent liabilities are not recognized in the financial statements as liabilities. These are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the financial statements as assets but disclosed when an inflow of economic benefits is probable. When the inflow of economic benefits is certain, an asset is recognized.

Events After the End of the Reporting Period
Post year-end events that provide additional information about the Bank's position at the end of the reporting period (adjusting events) are reflected in the financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the financial statements when material.

Capital Funds
Share capital is classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

The Bank's share capital includes ordinary shares. Shareholders have the right to vote and receive dividends whenever declared. Any cash dividends due on delinquent shares shall be first applied to the unpaid balance on the subscription, plus other incidental costs and expenses.

Stock dividends distributable represent the unissued stock dividends declared by the Bank payable to the Bank's holder of common shares.

Retained earnings includes all current and prior period results of operations as reported in profit or loss section of the statement of comprehensive income. Prior period adjustments to surplus would include adjustments relating to changes in accounting policies and errors in which retrospective restatement of financial statements is practicable.

Cumulative remeasurement gain on retirement plan comprises of experience adjustments (the effect of differences between the previous actuarial assumptions and what has actually occurred) and the effects of changes in actuarial assumptions. This is recognized in the statement of financial position immediately, with a charge to other comprehensive income in the period in which it occurs.

Revenue Recognition
Revenue is measured at fair value of the consideration received or receivable. Specific recognition criteria are applied to each of the following significant categories of revenue:

Sale of ROPA/Profit from assets sold or exchanged
Revenue from sale of properties is recognized when:

- the Bank has transferred to the buyer the significant risks and rewards of ownership of the properties;
- the Bank retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the properties sold;
- the amount of revenue can be reliably measured;
- it is probable that the economic benefits associated with the transaction will flow to the Bank; and

- the costs incurred or to be incurred in respect of the transaction can be reliably measured.

For the sale of ROPA installment, revenue is accounted for using the full accrual method. Under this method, sale is recognized when the earnings process is virtually complete and collectability of the entire sales price is reasonably assured. Installment collections from the sale of ROPA, which did not qualify from revenue recognition, are treated as customers' deposit accounted for as accounts payable in the Banks' books of accounts.

Interest
Interest income from bank deposits is recognized when earned. Interest income from investments is recognized when it is probable that the economic benefits will flow to the Bank and the amount of income can be reliably measured. Interest income is accrued on a timely basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Penalties
Penalties are recognized only upon collection or accrued when there is reasonable assurance of collection.

Service charges and fees
Fees earned from providing services are recognized when the service is completed. Service charges and fees that are directly related to acquisition and origination of loans are included in the cost of receivable and are amortized over the term of the loan taking into account the effective interest method.

<u>Leases – the Bank as Lessee</u>
Operating lease
Operating lease payments are recognized as an expense in the statement of comprehensive income on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which the economic benefits from the leased assets are consumed or the payments to the lessor are structured to increase in line with expected general inflation. The Bank recognizes cancellable leases as expense based on the term of the lease. Contingent rental is recognized as an expense in the period in which it is incurred.

<u>Earnings Per Share</u>
Earnings per share is computed by dividing the net income for the year attributable to members by the weighted average number of ordinary shares outstanding during the year, after adjustments for any subsequent share dividends declared to shareholders and dividends payable to preference shareholders.

<u>Employee Benefits</u>
Short-term Employee Benefits
This includes salaries, wages, paid vacation and sick leaves, bonuses, government dues and non-monetary benefits such as medical and dental, which are recognized as an expense in the period in which the service has been rendered by the employees.

Long-term Employee Benefits
This includes employee benefits other than termination benefits such as long-term compensated absences, long-service benefits and long-term disability benefits which are recognized as an expense at the date they are incurred.

Termination Benefits
Termination benefits are recognized when, and only when, the Bank is demonstrably committed to either terminate the employment of an employee or group of employees before the normal retirement date or to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy. These benefits are discounted when they fall due after more than 12 months.

Retirement Costs
Retirement benefits are actuarially determined using the projected unit credit cost method which reflects the services rendered by employees up to valuation date and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, experience adjustments and changes in actuarial assumptions.

Advertising and Promotional Activities
Advertising and promotional activities in introducing the services of the Bank are recognized as an expense in profit or loss when incurred.

Cost and Expense
Costs and expenses are recognized in profit or loss upon utilization of goods and services at the date they are incurred.

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

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

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

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

Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity, respectively.

3. Summary of Significant Accounting Judgments and Estimates

In preparing the financial statements of the Bank, the Management has made its best judgments and estimates relating to certain amounts, giving due consideration to materiality. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

Estimates and judgments 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.

The Bank believes that the following represent a summary of these significant judgments and estimates and related impact and associated risks in its financial statements:

Determination of functional currency
Based on the economic substance of the underlying circumstances relevant to the Bank, the functional currency of the Bank has been determined to be the Philippine peso.

The Philippine peso is the currency of the primary economic environment in which the Bank operates. It is the currency that mainly influences the Bank's revenue and expenses.

Unquoted debt securities classified as loans
The Bank classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis. If Management believes that there is no reference to market value, the said financial asset will be classified as "unquoted debt securities classified as loans".

As of December 31, 2018 and 2017, the Bank's unquoted debt securities classified as loans amounted to ₱ 1,950,056.

Estimating allowance for expected credit losses on loans and receivables
The Bank reviews its problem loans and receivables at each reporting date to assess whether an allowance for credit impairment should be recorded in the statement of comprehensive income. In particular, judgment by Management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and receivables, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance is based on any deterioration in the internal rating of the loan or investment since it was granted or acquired.

These internal ratings take into consideration of factors such as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

The Bank, however, is required by the BSP to set up an allowance for expected credit losses on loan accounts based on its existing loan loss provisioning. As of December 31, 2018 and 2017, the allowance for expected credit losses on loans and receivables amounted to ₱ 29,920,506 and ₱ 29,349,315, respectively (Note 7).

Further, the Bank has written-off loans and receivables amounting to ₱ 2,014,929 in 2018 and none in 2017 (Note 7).

Estimating allowance for expected credit losses on accrued interest and accounts receivables
Provisions are made for accounts identified to be doubtful of collection. The level of this allowance is evaluated by Management on the basis of factors that affect the collectibility of the accounts.

The Bank's allowance for expected credit losses on accrued interest and accounts receivables aggregated to ₱ 163,409 and ₱ 23,564 as of December 31, 2018 and 2017, respectively (Note 12).

Recognition of deferred income taxes
Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant Management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

As of December 31, 2018 and 2017, the Bank has deferred tax asset amounting to ₱ 9,062,422 and ₱ 9,060,497 and deferred tax liability of ₱ 192,793 and none, respectively (Note 20).

Estimating useful lives of investment properties, bank premises, furniture, fixtures and equipment, and intangible assets
Useful lives of investment properties, bank premises, furniture, fixtures, and equipment, and intangible assets are estimated based on the periods over which the assets are expected to be available for use. Such estimation is based on a collective assessment of similar businesses, internal technical evaluation and experience with similar assets.

The estimated useful lives of investment properties, bank premises, furniture, fixtures, and equipment and intangible assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical and commercial obsolescence and legal or other limits on the use of the assets.

It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any item of investment properties and bank premises, furniture, fixtures and equipment would increase the recorded operation expenses and decrease the carrying value of investment properties and bank premises, furniture, fixtures and equipment and intangible assets and vice versa.

There is no change in the estimated useful lives of investment properties and bank premises, furniture, fixtures and equipment in both years.

The net book value of bank premises, furniture, fixtures and equipment amounted to ₱ 10,391,886 and ₱ 9,175,211 as of December 31, 2018 and 2017, respectively (Note 10).

The net book value of investment properties amounted to ₱ 7,615,397 and ₱ 4,962,299 as of December 31, 2018 and 2017, respectively (Note 9).

The net book value of intangible assets amounted to ₱ 873,001 and ₱ 2,120,591 as of December 31, 2018 and 2017, respectively (Note 11).

Present value of retirement obligation
The cost of defined benefit pension plan and other post-employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on plan assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of the plan, such estimates are subject to significant uncertainty.

The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as of the end of reporting period.

As of December 31, 2018 and 2017, the Bank has a pension asset of ₱ 642,644 and accrued retirement liability of ₱ 455,164, respectively (Note 21).

Impairment of investment properties, bank premises, furniture, fixtures and equipment and intangible assets
The Bank assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Bank considers important which could trigger an impairment review include the following:

a. Significant underperformance relative to expected historical or projected future operating results;
b. Significant changes in the manner of use of the acquired assets or the strategy for overall business; and

c. Significant negative industry or economic trends.

The Bank recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is computed using the value in use approach. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs.

No impairment loss has been recognized in both years.

Provisions and contingencies
The Bank provides for present obligations (legal and constructive) when it is probable that there will be an outflow of resources embodying economic benefits that will be required to settle said obligations.

An estimate of the provision is based on known information at the reporting date, net of any estimated amount that may be reimbursed by the Bank. If the effect of the time value of money is material, provisions are discounted using a current pretax rate that reflects the risks specific to the liability. The amount of provision is being re-assessed at least on an annual basis to consider new relevant information.

The Bank has not recognized any provision in both years.

4. Cash and Other Cash Items

		2018		2017
Cash in vault	₱	**5,696,057**	₱	5,488,172
Checks and other cash items		**1,375,000**		-
	₱	**7,071,057**	₱	5,488,172

Cash in vault refers to the total amount of cash in the Bank's vault in the form of notes and coins under the custody of cashier or cash custodian or treasurer, including notes in the possession of tellers.

Checks and other cash items refer to the Bank's checks drawn on other banks received after the clearing cut-off time until the close of regular banking hours and cash placed in the Bank's G-cash wallet.

5. Due from Bangko Sentral ng Pilipinas (BSP)

This consists of a savings deposit with the BSP, which forms part of the statutory reserve requirement of the Bank and serve as clearing account for interbank claims. Due from BSP amounted to ₱ 9,748,344 and ₱ 8,535,382 as of December 31, 2018 and 2017 respectively (Note 13).

Deposits maintained by banks with the BSP in compliance with the reserve requirement no longer earn interest since the effectivity of BSP Circular Nos. 830 and 832, Series of 2014.

6. Due from Other Banks

		2018		2017
Savings deposit	₱	**22,309,593**	₱	23,364,099
Demand deposit		**7,119,286**		17,649,663
Time deposit		**20,268,222**		11,559,274
	₱	**49,697,101**	₱	52,573,036

Savings deposits earn interest at 0.025% to 1.25% in both years and time deposits earn 1.50% to 3.25% in 2018 and 1.25% to 3.50% in 2017.

Interest income earned from due from other banks amounted to ₱ 338,609 in 2018 and ₱ 340,510 in 2017 (Note 22).

Interest accrued on time deposit placements as at December 31, 2018 and 2017 amounted to ₱ 21,901and ₱ 19,768, respectively.

7. Loans and Receivables – net

		2018		2017
Loans and receivables	₱	**319,206,764**	₱	259,272,763
Other agricultural credit loans		**26,370,791**		48,616,075
		345,577,555		307,888,838
Sales contract receivables (Note 9)		**2,493,943**		2,206,163
		348,071,498		310,095,001
Unearned interest and discounts		**(8,964,474)**		(7,316,466)
Allowance for expected credit losses		**(29,920,506)**		(29,349,315)
	₱	**309,186,518**	₱	273,429,220

The movements of the allowance for expected credit losses on loans and receivables are as follows:

		2018		2017
Balance, January 1	₱	**29,349,315**	₱	16,527,288
Add: Provisions during the year		**2,572,985**		12,822,027
Less: Accounts written-off		**(2,001,794)**		-
	₱	**29,920,506**	₱	29,349,315

The allowance for expected credit losses have been determined with due consideration to the BSP's existing guidelines on loan provisioning.

On December 31, 2018, the Board of Directors approved the write-off of 89 accounts of loans and receivables with aggregate value of ₱ 2,001,794.

The Management believes that there is no indication that additional provisions for expected credit losses or recoveries in excess of the recognized allowance for expected credit losses or recoveries as of December 31, 2018 and 2017 are necessary.

Percentage of total loans and receivables to total assets is 75% and 73% as of December 31, 2018 and 2017.

The loans earned annual interest rates which ranged from 3% to 36% and 8% to 36% in 2018 and 2017, respectively. On the other hand, sales contract receivables earned annual interest rates of 12% to 18% in both years. Interest earned on loans and receivables amounted to ₱ 49,153,119 and ₱ 48,062,938 in 2018 and 2017, respectively.

Loans and receivables carry nominal interest rates as follows:

	2018	2017
Maturing in:		
1 year	**3% - 22%**	8% - 22%
2 to 5 years	**18% - 36%**	18% - 36%

Non-performing loans and receivables include past due and items in litigation aggregating to ₱ 36,648,178 and ₱ 41,548,824 as of December 31, 2018 and 2017, respectively, as shown below (Note 28):

	2018	2017
Past due	**₱ 31,230,208**	₱ 38,597,128
Items in litigation	**5,417,970**	2,951,696
	₱ 36,648,178	₱ 41,548,824

The following table shows the breakdown of loans as to term:

	2018	%	2017	%
Short-term (one (1) year or less)	**₱ 127,189,666**	**37**	₱ 158,692,847	52
Medium-term (over one (1) year to five (5) years)	**218,387,889**	**63**	149,195,991	48
	₱ 345,577,555	**100**	₱ 307,888,838	100

The Bank holds collaterals against the loans and receivables from customers in the forms of real estate, chattel mortgages and others. It holds and annotates original documents such as certificates of registration for chattel mortgages and certificates of title for real properties. It requires insurance policy on collaterals in favor of the Bank. The breakdown of the Bank's secured and unsecured loans and receivables, and sales contract receivables are as follows:

	2018	%	2017	%
Secured				
Real estate mortgage	**₱ 38,367,770**	**11**	₱ 68,444,696	22
Chattel mortgage	**1,956,504**	**1**	16,627,038	5
Others	**75,897,010**	**22**	49,851,163	16
	116,221,284	**33**	134,922,897	43
Unsecured	**231,850,214**	**67**	175,172,104	57
	₱ 348,071,498	**100**	₱ 310,095,001	100

Unsecured loans are guaranteed by co-makers, who in the event of default will assume the loan balance.

Estimates of fair value of collaterals are based on the appraised value of collaterals at the time of borrowing as determined by the in-house appraisers of the Bank. The fair value of collaterals held against loans and receivables are as follows:

		2018	%
Real estate mortgage	₱	**175,696,050**	**63**
Chattel mortgage		**13,942,500**	**5**
Others		**88,237,696**	**32**
	₱	**277,876,247**	**100**

Loans and receivables with total carrying amount of ₱ 99,929,359 and ₱ 59,513,553 as at December 31, 2018 and 2017, respectively, were collateralized to secure bills payable (Note 14).

In accordance with Section X345 of the MORB, the total outstanding loans, other credit accommodations and guarantees to directors, officers, stockholders and related interests (DOSRI) shall not exceed 15% of the total loan portfolio of the Bank or 100% of its net worth, whichever is lower. However, in no case shall the total unsecured loans, other credit accommodations and guarantees to the said DOSRI exceed 30% of the aggregate ceiling or the outstanding loans, other credit accommodations and guarantees, whichever is lower.

As at December 31, 2018 and 2017, loans and other credit transactions with certain DOSRI amounting to ₱ 56,400,000 and ₱ 47,650,000, represented 16.32% and 15.48%, respectively (Note 18), of the total outstanding loan portfolio of the Bank.

All DOSRI loans as at December 31, 2018 and 2017 were fully secured by deeds of assignment on deposits and chattel mortgage.

The BSP considers that loan concentration exists when the total loan exposure to a particular industry exceeds 30% of the total loan portfolio. Information on the concentration of loans as to industry/economic activity are as follows:

		2018	%		2017	%
Private household with employed persons	₱	**193,164,734**	**56**	₱	121,929,220	40
Financial intermediation		**36,142,756**	**10**		32,037,833	10
Agriculture, forestry and fishing		**29,686,174**	**9**		53,845,007	18
Wholesale and retail trade; repair of motor vehicles and motorcycles		**23,703,385**	**7**		38,061,455	12
Education					10,000,000	3
Administrative and support service activities		**9,092,491**	**3**		-	-
Transportation and storage		**5,604,075**	**2**		-	-
Water supply, sewerage, waste management and remediation activities		**4,725,474**	**1**		-	-
Construction					233,993	-
Mining and quarrying		**4,678,329**	**1**		-	-
Real estate activities		**1,778,318**	**1**		9,100,951	3
Other service activities		**37,001,819**	**10**		42,680,379	14
	₱	**345,577,555**	**100**	₱	307,888,838	100

Based on the foregoing information, the Bank has the highest concentration of credit in private household with employed persons as of December 31, 2018 and 2017.

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

Interest income and other fees on loans and receivables amounted to ₱ 49,153,119 in 2018 and ₱ 48,062,938 in 2017.

8. Unquoted Debt Securities Classified as Loans

	2018	2017
Balance, January 1	**₱ 1,950,056**	₱ 2,682,971
Redemption	**-**	(732,915)
Balance, December 31	**₱ 1,950,056**	₱ 1,950,056

Agrarian reform bonds are bonds issued by Land Bank of the Philippines exclusively for lending to the agriculture and agrarian reform sector. These bonds are 10-year Agrarian Reform Coupon Bonds (ARCBs) with terms and maturities from January 22, 2009 to September 24, 2022. These bonds carry interest rates based on a 91-day treasury bill rate prevailing in the market.

These bonds were acquired by the Bank in compliance with the 25% mandatory agriculture and agrarian reform credit allocation required in Section X341.3 and X341.4 of the MORB.

Interest income earned from unquoted debt securities classified as loans amounted to ₱ 32,962 in 2018 and ₱ 33,509 in 2017 (Note 22).

The contractual maturity dates as at December 31, 2018 and 2017 of the investment in UDSCL are as follows:

	2018	2017
Due within 1 year	**₱ 1,465,830**	₱ 732,915
Due beyond 1 year	**484,226**	1,217,141
	₱ 1,950,056	₱ 1,950,056

9. Investment Properties

These are real and other properties acquired (ROPA) consisting of land and buildings and any improvements thereon held for capital appreciation which amounted to ₱ 7,615,397 and ₱ 4,962,299 as of December 31, 2018 and 2017, net of accumulated depreciation.

Movements of investment properties are as follows:

	Land	Building	2018	2017
Cost				
January 1	₱ 4,962,288	₱ 89,610	₱ **5,051,898**	₱ 7,777,864
Additions	3,713,632	-	**3,713,632**	1,196,680
Disposals	(718,127)	-	**(718,127)**	(1,898,583)
Transferred to sales contract receivables	(342,396)	-	**(342,396)**	(2,024,063)
December 31	7,615,397	89,610	**7,705,007**	5,051,898
Accumulated depreciation				
January 1	-	89,599	**89,599**	78,398
Provisions (Note 19)	-	11	**11**	11,201
December 31	-	89,610	**89,610**	89,599
Net book value	₱ 7,615,397	₱ -	₱ **7,615,397**	₱ 4,962,299

The appraised values of the investment properties as at December 31, 2018 and 2017 amounted to ₱ 19,773,722 and ₱ 9,563,685, respectively, determined by independent appraisers and in-house appraisers on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made. In accordance with Section 382 of the MORB, if the carrying amount of ROPA exceeds ₱ 5 million, the appraisal of the foreclosed purchased asset shall be conducted by an independent appraiser acceptable to the BSP. As at December 31, 2018 and 2017, the Bank has no ROPA with carrying amount in excess of ₱ 5 million.

In 2018, parcels of land costing ₱ 718,127 and ₱ 342,396 were sold in cash and in installment amounting to ₱ 1,309,711 and ₱ 960,200, respectively. Realized gain on sale on cash sales amounted to ₱ 591,584 (Note 19). The gain on installment sale amounted to ₱ 617,804, of which ₱ 123,561 was realized in 2018 (Notes 16 and 19).

In 2017, proceeds from cash sales of investment property costing ₱ 1,898,583 amounted to ₱ 5,750,000 with a gain on sale (net of transaction cost ₱ 250,000) amounted to ₱ 3,601,417 (Note 19). Further, disposal of investment properties costing ₱ 2,024,063 was made through the sales contract receivable for a total contract price of ₱ 2,962,560. Deferred gain recognized amounted to ₱ 938,497 of which ₱ 242,975 and ₱ 60,050 was realized in 2018 and 2017, respectively (Notes 16 and 19).

Sales contract receivables amounted to ₱ 2,493,943 and ₱ 2,206,163 as of December 31, 2018 and 2017, respectively (see Note 7). Further, deferred gain amounted to ₱ 1,129,715 and ₱ 878,447 as of December 31, 2018 and 2017, respectively (Note 16).

The Bank realized no other income from the investment properties other than the gain on sale of investment properties. Litigation expenses incurred on the assets acquired amounted to ₱ 1,083,949 and ₱ 285,657 in 2018 and 2017, respectively and are reported in administrative expenses in the statement of comprehensive income (Note 19).

10. Bank Premises, Furniture, Fixtures and Equipment

	Leasehold Improvements	Information Technology Equipment	Furniture, Fixtures and Equipment	Transportation Equipment	2018 Total	2017 Total
Cost						
January 1	₱ 10,040,043	₱ 3,658,846	₱ 5,541,022	₱ 1,228,228	**₱ 20,468,139**	₱ 20,065,121
Additions	1,438,275	1,754,141	208,046	-	**3,400,462**	421,210
Derecognition/ Disposals	-	(181,625)	(72,507)	-	**(254,132)**	(45,400)
Reclassification	-		-	-	**-**	27,208
December 31	11,478,318	5,231,362	5,676,561	1,228,228	**23,614,469**	20,468,139
Accumulated Depreciation						
January 1	3,656,502	2,778,859	3,822,023	1,035,544	**11,292,928**	9,473,821
Depreciation (Note 19)	942,327	629,828	535,980	113,304	**2,221,439**	1,836,751
Derecognition / Disposals	-	(181,625)	(72,507)	-	**(254,132)**	(45,400)
Reclassifications	-	-	-	(37,652)	**(37,652)**	27,756
December 31	4,598,829	3,227,062	4,285,496	1,111,196	**13,222,583**	11,292,928
Net book value	₱ 6,879,489	₱ 2,004,300	₱ 1,391,065	₱ 117,032	**₱ 10,391,886**	₱ 9,175,211

The foregoing properties were not pledged as collaterals to secure any liabilities of the Bank.

Total gross carrying amount of fully depreciated assets still in use amounted to ₱ 4,222,397 and ₱ 4,470,580 as at December 31, 2018 and 2017, respectively.

Management believes that there is no indication of impairment on the Bank's premises, furniture, fixtures and equipment and that their net carrying amounts can be recovered through use in operations.

The Bank has no contractual commitment to purchase any items of the Bank's premises, furniture, fixtures and equipment in both years.

Under BSP rules, investments in bank premises, furniture, fixtures and equipment should not exceed 50% of the Bank's unimpaired capital. As at December 31, 2018 and 2017, the Bank's investment in its bank premises, furniture, fixtures and equipment were 18.84% and 17.45% of its unimpaired capital, respectively, and has satisfactory complied with this BSP requirement.

11. Other Intangible Assets

	2018	2017
Cost		
January 1	**₱ 3,522,277**	₱ 3,022,317
Additions	**135,000**	499,960
Derecognition	**(432,099)**	-
December 31	**3,225,178**	3,522,277
Accumulated amortization		
January 1	**1,401,686**	1,187,807
Amortization (Note 19)	**1,382,590**	214,427
Derecognition/Reclassification	**(432,099)**	(548)
December 31	**2,352,177**	1,401,686
Net book value	**₱ 873,001**	₱ 2,120,591

Other intangible assets consist of the Bank's acquired accounting software and other software licenses.

12. Other Assets

		2018		2017
Accrued interest receivables	₽	**3,409,207**	₽	6,418,766
Accounts receivable		**432,365**		585,747
Prepaid expenses		**914,759**		592,076
Stationeries and supplies		**758,895**		923,540
Petty cash fund		**26,000**		26,000
Others		**1,043,059**		1,015,598
		6,584,285		9,561,727
Allowance for expected credit losses on accounts receivables		**(139,858)**		(13)
Allowance for expected credit losses on accrued interest receivables		**(23,551)**		(23,551)
	₽	**6,420,876**	₽	9,538,163

Movements of allowance for expected credit losses on accounts receivables and accrued interest receivables are as follows:

		Accounts Receivables		Accrued Interest Receivables		2018		2017
Balance, January 1	₽	13	₽	23,551	₽	**23,564**	₽	41,618
Add: Provisions		139,845		-		**139,845**		-
Less: Reversals		-		-		**-**		(18,054)
Balance, December 31	₽	139,858	₽	23,551	₽	**163,409**	₽	23,564

Accounts receivable and accrued interest receivable as at December 31, 2018 and 2017 were all due within 1 year from the respective financial reporting dates. These include receivable from employees and accrued interest on time deposits, investment in UDSCL and loans receivables.

Prepayments include prepaid expenses for fire, money security, vehicle insurances and fidelity bonds of the authorized and accountable officers of the Bank and membership fee of Bancnet, Inc.

Others include refundable rental deposits amounting to ₽ 304,608 and ₽ 196,150 as of December 31, 2018 and 2017, respectively (Note 23).

Management believes that there are no additional provisions for expected credit losses or recoveries in excess of the recognized allowance for expected credit losses or recoveries as of December 31, 2018 and 2017 are necessary.

13. Deposit Liabilities

		2018		2017
Demand deposits	₱	**13,483,384**	₱	16,888,920
Savings deposits		**109,779,211**		103,610,393
Time deposits		**111,058,142**		128,591,643
	₱	**234,320,737**	₱	249,090,956

The following table shows the breakdown of time deposits as to maturity:

		2018		2017
Short-term (one (1) year or less)	₱	**110,044,416**	₱	127,577,917
Medium-term (over one (1) year to five (5) years)		**1,013,726**		1,013,726
	₱	**111,058,142**	₱	128,591,643

Savings and time deposit liabilities bear fixed annual interest rates that ranges from 1% to 3% in both years. Interest expense on deposit liabilities amounted to ₱ 4,509,491 in 2018 and ₱ 4,608,034 in 2017. Demand deposit liabilities do not earn interest.

In 2014, the applicable statutory reserves requirement against the rural bank's deposit and deposit substitute liabilities in local currency were increased to 3% and 5% for savings and time deposits, and for demand deposits, respectively.

The statutory reserve requirements as of December 31 are shown below:

		2018		2017
Due from BSP (see Note 5)	₱	**9,748,344**	₱	8,535,382
Savings deposits		**109,779,211**		103,610,393
Time deposits		**111,058,142**		128,591,643
		220,837,353		232,202,036
Reserve rate		**3%**		3%
Required statutory/legal reserve for savings and time deposit liabilities		**6,625,121**		6,966,061
Demand deposit		**13,483,384**		16,888,920
Reserve rate		**5%**		5%
Required statutory/legal reserve for demand deposit liabilities		**674,169**		844,446
Total required statutory/legal reserve	₱	**7,299,290**	₱	7,810,507

Reserves are required to be kept in the form of deposits placed in banks' Demand Deposit Accounts (DDA) with the BSP.

14. Bills Payable

	2018	2017
Balance, January 1	**₱ 57,086,520**	₱ 45,770,248
Availment	**112,576,720**	63,964,787
Payment	**(69,659,701)**	(52,648,515)
Balance, December 31	**₱ 100,003,539**	₱ 57,086,520

In 2015, the Bank has applied for a term loan rediscounting facility amounting to ₱ 40 million with the Land Bank of the Philippines with a purpose of augmenting its working capital. Availability end and expiry are dated May 31, 2016 and May 31, 2026, respectively. Interest rates of the loan range from 6.50% to 8.10% per annum in 2018 and 6.50% to 7.22% per annum in 2017. The line of credit is collateralized by assignment of sub-borrowers' promissory notes and all underlying capital.

In 2017, the Bank has a new approved credit line with United Coconut Planters Bank (UCPB - Savings) amounting to ₱ 20 million with an annual interest rate of 8% to support the Bank with its operations. This line of credit is collateralized by assignment of sub-borrowers' promissory notes.

Loans and receivables with total carrying amount of ₱ 99,929,359 and ₱ 59,513,553 as of December 31, 2018 and 2017, respectively, were collateralized to secure bills payable (see Note 7).

Interest expense on bills payable amounted to ₱ 7,253,306 in 2018 and ₱ 3,730,249 in 2017.

15. Accrued Interest and Other Expenses

	2018	2017
Accrued interest	**₱ 3,510,641**	₱ 1,841,234
Accrued taxes	**980,837**	-
Accrued rent per PAS 17	**124,160**	373,616
Other accrued expenses	**1,145,143**	1,146,270
	₱ 5,760,781	₱ 3,361,120

Accrued taxes pertain to the gross receipts tax due from banking and non-banking transactions of the Bank.

Other accrued expenses include utility bills, professional fees, PDIC insurance fee, security services and others.

16. Other Liabilities

		2018		2017
Accounts payable	₱	**1,168,581**	₱	1,734,529
Deferred gain (see Note 9)		**1,129,715**		878,447
SSS, HDMF and Philhealth premiums		**194,379**		80,377
Withholding taxes payable (Note 22)		**72,649**		72,423
Others		**34,550**		44,134
	₱	**2,599,874**	₱	2,809,910

Movements of deferred gain for the year ended December 31 are as follows:

		2018		2017
Balance, January 1	₱	**878,447**	₱	-
Additions: Deferred during the year		**617,804**		938,497
Less: Realized during the year				
From 2018 disposals (see Notes 9 and 19)		**(123,561)**		(60,050)
From 2017 disposals (see Notes 9 and 19)		**(242,975)**		-
Balance, December 31	₱	**1,129,715**	₱	878,447

17. Share Capital

		2018		2017
Authorized share capital – 100 par value per share				
Preferred shares – 40,000 shares	₱	**4,000,000**	₱	4,000,000
Common shares – 460,000 shares		**46,000,000**		46,000,000
	₱	**50,000,000**	₱	50,000,000

		2018		2017
Outstanding common shares – issued and fully paid – 460,000 shares	₱	**46,000,000**	₱	46,000,000
Share premium		**7,030**		7,030
	₱	**46,007,030**	₱	46,007,030

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

There were no issued preferred shares as at December 31, 2018 and 2017.

In 2018, the Board of Directors approved the increase in its authorized share capital from ₱ 50 million to ₱ 200 million by way of stock dividend declaration. Likewise, the Board approved the declaration of stock dividends aggregating to ₱ 14 million, which was presented as stock dividends distributable as of December 31, 2018. The retained earnings available for declaration as at December 31, 2018 is shown on the next page:

		2018
Retained earnings, January 1	₱	**15,525,399**
Net income during the year		**7,611,753**
Less: Capital adjustment		
Deferred tax asset (net of deferred tax liability)		**8,869,629**
Retained earnings available for dividend declaration		**14,267,523**
Stock dividends declared		**(14,000,000)**
Net amount available for dividend declaration	₱	**267,523**

As at March 6, 2019, the Bank is still in the process of preparing and securing the requirements for the application for increase in authorized share capital.

18. Related Party Transactions

a. Under the General Banking Act and BSP regulations, the aggregate amount of loans to DOSRI should not exceed the total capital funds or 15% of the total loan portfolio of the Bank, whichever is lower, except with prior approval from the Monetary Board. In addition, the amount of direct credit accommodations to DOSRI, of which 70% must be secured, should not exceed the book value of their respective investments in the Bank.

As at December 31, 2018 and 2017, information about the loans and other credit transactions with certain DOSRI are as follows:

	2018	2017
Loans and other credit transactions with certain DOSRI (see Note 7)	**₱ 56,400,000**	₱ 47,650,000
Outstanding total loan portfolio (see Note 7)	**₱ 345,577,555**	₱ 307,888,838
Percent of DOSRI loans to total loan portfolio	**16.32%**	15.48%
Percent of unsecured DOSRI loans to total DOSRI loans	**0.00%**	0.00%
Percent of past due DOSRI loans to total DOSRI loans	**0.00%**	0.00%
Percent of non-performing DOSRI loans to total DOSRI loans	**0.00%**	0.00%

The significant transactions with related parties and their effect on the Bank's financial statements for the years ended December 31 are shown below:

		Loans and other receivables					
Related Parties	**Relationship**	**Net Volume**	**2018**	**Net Volume**	**2017**	**Terms**	**Condition**
GFC	Related interest	₱ 5,400,000	**₱ 30,400,000**	(₱ 11,750,000)	₱ 25,000,000	1 year; payable monthly	Fully secured
DSMG	Related interest	3,500,000	**13,500,000**	10,000,000	10,000,000	8 months; payable monthly	Fully secured
LDCU	Related interest	-	**10,000,000**	10,000,000	10,000,000	1 year; payable monthly	Fully secured
FLC	Related interest	-	**2,500,000**	2,500,000	2,500,000	1 year; payable monthly	Fully secured
PDR	Related interest	(150,000)	**-**	150,000	150,000	3 months; payable monthly	Fully secured
ZHI	Related interest	-	**-**	15,250,000	-	1 year; payable monthly	Fully secured
	Total	₱ 8,750,000	**₱ 56,400,000**	₱ 26,150,000	₱ 47,650,000		

Related Parties	Relationship	Deposit liabilities Volume	2018	Volume	2017	Terms	Condition
GFC	Related interest	₱ 7,508,249	**₱ 37,503,630**	(₱ 14,548,629)	₱ 29,995,381	1 year; payable monthly	Assigned
DSMG	Related interest	4,437,248	**15,439,507**	11,002,259	11,002,259	8 months; payable monthly	Assigned
LDCU	Related interest	(5,089,466)	**11,704,560**	11,353,485	16,794,026	1 year; payable monthly	Assigned
FLC	Related interest	84,704	**3,614,059**	(5,193,636)	3,529,355	1 year; payable monthly	Assigned
PDR	Related interest	(269,391)	**-**	474,953	269,391	3 months; payable monthly	Assigned
ZHI	Related interest	-	**-**	27,124,247	-	1 year; payable monthly	
	Total	₱ 6,671,344	**₱ 68,261,756**	₱ 30,212,679	₱ 61,590,412		

Gopel Finance Corporation (GFC), Factors Lending Corporation (FLC), Liceo de Cagayan University (LCU), Divine Shepherd Memorial Gardens (DSMG), Paseo del Rio (PDR) and Zealep Hotels, Inc. (ZHI) are companies controlled by the same key management personnel of the Bank.

The outstanding accounts with the related interests shall be settled in cash. Impairment assessment is made each financial year through a review of the financial position of a related interest and market in which the related interest operates. Management believes that the aforementioned accounts are recoverable within the Bank’s normal operating cycle.

b. Short-term employee benefits to key management personnel, which include salaries, 13th month pay and other short-term benefits, charged to operations amounted to ₱ 4,710,830 in 2018 and ₱ 4,237,740 in 2017.

c. No post-employment and other long-term benefits and share-based payments have been paid to key management personnel except for directors’ fee paid amounting to ₱ 404,000 in 2018 and ₱ 394,000 in 2017 (Note 19).

19. Income and Expenses

Other income

	2018	2017
Service charges, fees and commissions	**₱ 10,227,470**	₱ 7,844,702
Gain on sale of investment properties (see Notes 9 and 16)	**958,120**	3,661,467
Miscellaneous income	**6,777,869**	5,854,427
	₱ 17,963,459	₱ 17,360,596

Service charges, fees and commissions refer to income from intermediation services such as those relating to deposit and lending services.

Gain on sale of investment properties represents income from foreclosed properties subsequently sold. It is determined as the difference between the net disposal proceeds and the carrying amount of the asset, which is recognized in profit or loss in the period of disposal.

Miscellaneous income refers to interest income from sales contract receivables, inspection and filing fees collected relative to the loans released and penalties on past due loans, rental income from safety deposit boxes, notarial fees and other charges.

Administrative expenses

	2018	**2017**
Salaries and wages	**₱ 12,947,031**	₱ 12,832,674
Employees' benefits	**5,439,448**	3,640,267
Taxes and licenses (Note 22)	**3,675,550**	1,841,576
Depreciation and amortization (see Notes 9, 10 and 11)	**3,604,040**	2,062,379
Rent (Note 23)	**2,661,515**	2,888,636
Security, clerical, messengerial and janitorial services	**1,838,689**	1,672,965
Postage, telephone, cables and telegrams	**1,247,948**	1,255,370
Transportation and travel	**1,084,362**	690,643
Litigation costs (see Note 9)	**1,083,949**	285,657
SSS, PHIC, and HDMF contributions	**1,057,814**	897,245
Fuel and lubricants	**947,359**	959,620
Light, power and water	**925,261**	890,748
Insurance	**918,794**	951,826
Management and other professional fees	**911,152**	1,183,593
Fines, penalties and other charges (Note 22)	**685,794**	-
Entertainment, amusement and recreational (Note 26)	**640,472**	549,211
Stationeries and supplies	**531,948**	576,957
Repairs and maintenance	**455,737**	402,008
Directors' fee (see Note 18)	**404,000**	394,000
Provisions for retirement benefits (Note 21)	**290,984**	388,385
Fees and commissions	**117,534**	-
Membership fees and dues	**41,295**	23,616
Advertising	**36,222**	47,386
Donations and charitable contributions	**27,700**	53,350
Miscellaneous	**363,636**	526,236
	₱ 41,938,234	₱ 35,014,348

Miscellaneous include information technology expenses, BSP supervision fees, freight charges and other expenses.

20. Income Tax

Deferred tax assets as of December 31 relate to the following:

		2018		2017
Allowance for expected credit losses	₱	**9,025,174**	₱	8,811,863
Accrued rent per PAS 17		**37,248**		112,085
Accrued retirement liability		**-**		136,549
	₱	**9,062,422**	₱	9,060,497

Deferred tax liability relates to pension asset which amounted to ₱ 192,793 as of December 31, 2018 and none as of December 31, 2017.

Significant components and the reconciliation of income tax expense to profit before income tax at the applicable statutory income tax rate to income tax expense at the Bank's effective income tax rate for the year ended December 31 are presented below:

		2018		2017
Profit before income tax	₱	**11,074,288**	₱	9,622,895
At applicable statutory income tax rate of 30%		**3,322,286**		2,886,868
Changes in income tax resulting from:				
Expenditures not allowable for income tax purposes		**1,152,864**		46,285
Expenditures allowable for income tax purposes		**(812,644)**		-
Interest income already subjected to final tax		**(111,471)**		(112,205)
Income not taxable for income tax purposes		**(74,837)**		-
Income tax expense – current		**3,476,198**		2,820,948
Tax effects of net movement in items giving rise to:				
Deferred tax assets relating to:				
Accrued retirement		**136,549**		-
Allowance for expected credit losses		**(213,311)**		-
Accrued rent expense per PAS 17		**74,837**		-
Deferred tax liability relating to:				
Pension asset		**192,793**		-
Remeasurement gain accounts in OCI		**(204,531)**		-
Income tax expense – deferred		**(13,663)**		-
	₱	**3,462,535**	₱	2,820,948

The reconciliation of the Bank's income tax payable for the year ended December 31, 2018 is as follows:

Balance, January 1, 2018	₱	**2,397,714**
Provision for income tax – current		**3,476,198**
Payments during the years		**(5,812,570)**
Balance, December 31, 2018	₱	**61,342**

21. Retirement Benefits

The Bank has an unfunded, non-contributory defined benefit retirement plan, covering all regular employees entitled to benefits based on a specific level of benefit for every year of service as provided under R.A. 7641. The Bank's latest actuarial valuation was conducted by Mr. Mariano M. Mercado for the period ended December 31, 2018.

Retirement costs charged to operations amounted to ₱ 290,984 in 2018 and ₱ 388,385 in 2017 (see Note 19). Pension asset amounted to ₱ 642,644 and accrued retirement liability amounted to ₱ 455,164 as of December 31, 2018 and 2017, respectively.

The principal assumptions used for the purpose of the actuarial valuation were as follows:

	2018	2017
Discount rate	7.52%	5.70%
Expected rate of salary increase	4.00%	4.00%
Expected return on plan assets	3.00%	3.00%

Provision for retirement benefits for the years ended December 31 (see Note 19) includes the following:

	2018	2017
Current service cost	₱ **265,022**	₱ 315,270
Interest cost on benefit obligation	**87,687**	87,614
Interest income on plan asset	**(61,725)**	(14,499)
	₱ **290,984**	₱ 388,385

Present values of defined benefit obligation were computed as follows:

	2018	2017
Beginning	₱ **1,537,347**	₱ 1,585,258
Current service cost	**265,022**	315,270
Interest cost on benefit obligation	**87,687**	87,614
Remeasurement loss (gain) resulting from:		
Financial assumptions	**(223,189)**	(403,764)
Experience	**(462,907)**	(47,031)
	₱ **1,203,960**	₱ 1,537,347

Fair values of plan assets were computed as follows:

	2018	2017
Beginning	₱ **1,082,183**	₱ 262,336
Contributions	**707,021**	788,968
Interest income from plan asset	**61,725**	14,499
Remeasurement gain (loss) from plan asset	**(4,324)**	16,380
	₱ **1,846,604**	₱ 1,082,183

The actual return on plan assets amounted to ₱ 57,400 in 2018 and ₱ 30,879 in 2017.

The movement of cumulative remeasurement gain (loss) under equity is as follows:

	2018			2017		
	Gain (loss)	**Deferred tax**	**Amount**	**Gain (loss)**	**Deferred tax**	**Amount**
Balance, January 1	**₱ 141,162**	**(₱ 42,348)**	**₱ 98,814**	(₱ 326,013)	₱ 97,804	(₱ 228,209)
Remeasurement gain (loss) on DBO	**686,096**	**(205,829)**	**480,267**	450,795	(135,239)	315,556
Remeasurement gain (loss) on FVPA	**(4,325)**	**1,298**	**(3,027)**	16,380	(4,913)	11,467
Balance, December 31	**₱ 822,933**	**(₱ 246,879)**	**₱ 576,054**	₱ 141,162	(₱ 42,348)	₱ 98,814

Accrued retirement liability (pension asset) as of December 31, 2018 and 2017 is as follows:

	2018	2017
Present value of defined benefit obligation	**₱ 1,203,960**	₱ 1,537,347
Fair value of plan assets	**1,846,604**	1,082,183
	(₱ 642,644)	₱ 455,164

The movements in net retirement benefit liability (asset) for the years ended December 31 recognized in the statement of financial position are as follows:

	2018	2017
Balance, January 1	**₱ 455,164**	₱ 1,322,922
Contributions	**(707,021)**	(788,968)
Retirement expense (see Notes 19 and 22)	**290,984**	388,385
Remeasurement (gain) loss on PVDBO	**(686,096)**	(450,795)
Remeasurement (gain) loss on FVPA	**4,325**	(16,380)
Balance, December 31	**(₱ 642,644)**	₱ 455,164

22. Supplementary Information Required under RR 15-2010 and RR 19-2011

Based on RR 15-2010

In compliance with the requirements set forth in RR 15-2010, herewith are the information on revenue taxes paid and accrued by the Bank during the taxable year:

Percentage tax

The Bank is a non-VAT registered entity and subjects its income with percentage taxes in accordance with Section 121 of the National Internal Revenue Code. The Bank's percentage tax amounted to ₱ 1,330,451 and ₱ 349,614 in 2018 and 2017, respectively.

Accrued percentage tax recorded under withholding taxes payable amounted to ₱ 980,837 in 2018 and none in 2017 (see Note 16).

Taxes and Licenses

This includes other taxes, local and national, paid or accrued for the years ended December 31, and lodged under the taxes and licenses account as shown on the next page (see Note 19):

		2018		2017
Local				
Business permits and other fees	₱	**397,475**	₱	345,268
Community tax certificates		**10,500**		8,641
Real property taxes		**9,068**		65,114
National				
Documentary stamps taxes		**1,799,534**		893,845
Percentage taxes		**1,330,451**		349,614
BIR annual registration fees		**3,500**		3,500
Others				
Others		**125,022**		175,594
	₱	**3,675,550**	₱	1,841,576

Withholding Taxes

The amounts of withholding taxes paid or accrued for the years ended December 31 are presented below:

	Compensation	Expanded	Final	Total 2018	Total 2017
January 1	₱ -	(₱ 16,892)	₱ 89,315	₱ **72,423**	₱ 94,256
Withheld during the year	26,680	297,545	807,587	**1,131,812**	1,425,319
Paid during the year	(25,680)	(243,477)	(862,429)	**(1,131,586)**	(1,447,152)
December 31	₱ 1,000	₱ 37,176	₱ 34,473	₱ **72,649**	₱ 72,423

Accrued withholding taxes are recorded under other liabilities (see Note 16).

Based on RR 19-2011

The Bank is not engaged in multiple activities with tax relief under special laws and international treaty. The Bank's income and expenses are subject to normal income tax rate of 30% except for the following income and expenses:

a. Income which are non-taxable for income tax purposes are shown below:

		2018		2017
Interest income subjected to 20% final tax (see Notes 6 and 8)	₱	**371,571**	₱	374,019
Reversal of rent expense per PAS 17		**249,456**		-
	₱	**621,027**	₱	374,019

b. Expenses which are non-deductible for income tax purposes are shown below:

		2018		2017
Provisions for credit and impairment losses (see Notes 7 and 12)	₱	**2,154,774**	₱	12,822,027
Penalties (see Note 19)		**685,794**		-
Provisions for retirement benefits (see Notes 19 and 21)		**290,984**		-
Interest expense		**153,273**		154,283
	₱	**3,284,825**	₱	12,976,310

Penalties pertain to late remittances of mandatory government dues, documentary stamps tax and capital gains tax, penalties sanctioned by the BSP for non-compliance, telephone bills and other charges (see Note 19).

23. Operating Lease Arrangements

The Bank entered into operating lease agreements for its offices from various lessors at monthly rentals subject to escalation rate ranging from 5% to 10% provided for in its contracts of lease up to 2023. Rental expense charged to operations amounted to ₱ 2,661,515 and ₱ 2,888,636 in 2018 and 2017, respectively (see Note 19), net of reversal of rent expense per PAS 17 amounting to ₱ 249,455 in 2018 (see Note 22).

Future minimum lease payments as of December 31, 2018 and 2017 follow:

	2018	2017
Due not later than 1 year	**₱ 2,079,558**	₱ 2,106,593
Due not later than 1 year but not later than 5 years	**3,719,365**	1,592,890
	₱ 5,798,923	₱ 3,699,483

Refundable rental deposits amounted to ₱ 304,608 and ₱ 196,150 as of December 31, 2018 and 2017, respectively (see Note 12).

24. Earnings Per Share and Basic Ratios

Earnings per share is computed by dividing the profit for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year, after adjustments for any subsequent share dividends declared.

	2018	2017
Profit for the year attributable to ordinary equity	**₱ 7,611,753**	₱ 6,801,947
Weighted average number of common shares outstanding	**460,000**	460,000
Earnings per share	**₱ 16.55**	₱ 14.79

There were no dilutive potential ordinary shares for years ended December 31, 2018 and 2017. Therefore, the Bank's basic and diluted earnings per share were equal for the years ended December 31, 2018 and 2017. There were also no movements in shares outstanding in 2018 and 2017.

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

	2018	2017
Return on average equity	**11.49%**	12.58%
Return on average assets	**1.88%**	1.97%
Net interest margin	**10.70%**	11.61%

25. Risk-Based Capital Ratio

As of December 31, 2018, and 2017, the Bank's risk-based capital adequacy ratio is 15.17% and 14.57%, respectively.

	2018	2017
Tier 1 (core) capital		
Common shares	**₱ 46,000,000**	₱ 46,000,000
Additional paid-in capital	**7,030**	7,030
Surplus	**15,525,399**	8,723,452
Undivided profits	**7,611,753**	6,801,947
	69,144,182	61,532,429
Less: Deferred tax asset, net of deferred tax liability	**8,869,629**	9,060,497
Tier 1 CAR	**60,274,553**	52,471,932
Tier 2 CAR – GLLP	**2,570,659**	2,226,559
Total qualifying capital	**62,845,212**	54,698,491
Risk weighted assets	**350,880,798**	326,052,000
Operational risk-weighted assets	**71,333,769**	52,798,000
Total risk-weighted assets	**₱ 422,214,567**	₱ 378,850,000
CAR ratio	**14.88%**	14.44%

26. Entertainment, Amusement and Recreational Expenses

Revenue Regulations (RR) No. 10-2002 defines expenses to be classified as entertainment, amusement and recreational (EAR) expenses and sets a limit for the amount that is deductible for tax purposes. EAR expenses are limited to 0.5% of net sales for seller of goods or properties or 1% of net revenue for seller of services. For sellers of both goods or properties and services, an apportionment formula is used in determining the ceiling on such expenses. EAR expense amounted to ₱ 640,472 in 2018 and ₱ 549,211 in 2017 (see Note 19).

27. Capital Management

The main objective of the Bank in managing capital is to comply with the regulatory capital requirements of the Bangko Sentral ng Pilipinas (BSP). The Bank wants to ensure its ability to continue as a going concern and to maintain adequate capital to support its operations and maximize shareholders' interest.

The Bank monitors capital on the basis of the risk based capital ratio. The Bank determines the levels of risk-weighted assets and sets the amount of qualifying capital required to support these assets.

To maintain or adjust capital, the Bank may raise capital through the issuance of additional shares or decrease capital through dividend declaration. The Bank's capital consists mainly of share capital, retained earnings free and reserves.

Capital requirement
Under existing regulations, banks are required to maintain daily, a risk – based capital ratio of not less than 10%.

The ratio, expressed as a percentage of qualifying capital to risk weighted assets, is determined by the risk assets of banks, on balance sheet and off balance sheet, measured and risk weighted according to defined criteria. Risk assets are defined as total assets less cash on hand, due from BSP, loans covered by holdout or assignment of deposits, loans or acceptances under letters of credit to the extent covered by marginal deposits and other non-risk items as determined by the Monetary Board. Qualifying capital available to banks is the sum of Tier 1 (core) capital, which is primarily the shareholders' equity with certain adjustments defined by regulation, and Tier 2 (supplementary) capital, which consists of long term subordinated debt.

The Bank has complied with the capital adequacy requirement throughout 2018 and 2017 since it has a capital adequacy ratio of 14.88% and 14.44% as of December 31, 2018 and 2017, respectively.

28. Financial Risk Management Objectives and Policies

The Bank's principal financial instruments consist of cash and other cash items, due from BSP and other banks, loans and receivables, unquoted debt securities classified as loans, pension asset, other assets, deposits and other liabilities, bills payable, accrued interest and other expenses, accrued retirement liability and other liabilities.

The Board of Directors has the ultimate responsibility for understanding the nature and level of overall risk taken by the Bank. In order to carry out its responsibilities, it establishes and develops strategies and policies with respect to the financial risk it identifies and it provides adequate supervision of day-to-day operations. The directors and senior officers regularly attend board meetings to review and discuss the Bank's financial condition and evaluate the performance vis-à-vis projections.

Credit Risk
Credit risk is the risk that arises from counterparty's failure to meet the terms of any contract with the Bank or otherwise perform as agreed.

The Bank has credit policies and procedures which are adequate and are reviewed periodically. The Bank maintains a strict implementation on its credit policies and identifies concentration of credit risks so as not to expose the Bank to adverse credit conditions. It also formulates strategies and adopts effective credit administration, review and monitoring through periodic evaluation of loan accounts.

As of December 31, 2018 and 2017, past due and items in litigation loans and receivables with an aggregate amount of ₱ 36,648,178 and ₱ 41,548,824, respectively, are the significant exposures to credit risk without taking account of any collateral held or other credit enhancements (see Note 7).

The table shows the credit quality of the Bank's financial assets as of December 31, 2018 and 2017:

	As of December 31, 2018		
	Neither past due nor impaired	**Past due and impaired**	**Total**
Cash and other cash items	₱ 7,071,057	₱ -	₱ **7,071,057**
Due from BSP	9,748,344		**9,748,344**
Due from other banks	49,697,101		**49,697,101**
Loans and receivables – net	272,538,340	36,648,178	**309,186,518**
Unquoted debt securities classified as loans	1,950,056		**1,950,056**
Pension asset	642,644		**642,644**
Other assets	4,008,771	163,409	**4,172,180**
	₱ 345,656,313	₱ 36,811,587	₱ **382,467,900**

	As of December 31, 2017		
	Neither past due nor impaired	**Past due and impaired**	**Total**
Cash and other cash items	₱ 5,488,172	₱ -	₱ 5,488,172
Due from BSP	8,535,382		8,535,382
Due from other banks	52,573,036		52,573,036
Loans and receivables – net	231,880,378	41,548,842	273,429,220
Unquoted debt securities classified as loans	1,950,056		1,950,056
Other assets	7,203,099	23,564	7,226,663
	₱ 307,630,123	₱ 41,572,406	₱ 349,202,529

Past due and impaired financial assets that are covered by an allowance for expected credit losses amounted to ₱30,083,915 and ₱29,372,879 as of December 31, 2018 and 2017, respectively (see Notes 7 and 12).

Liquidity Risk

Liquidity risk is the current and prospective risk to earnings or capital arising the Bank's inability to meet its obligations as they become due.

Past due and items in litigation loans and receivables amounting to ₱36,648,178 and ₱41,548,824 as of December 31, 2018, and 2017, respectively, have affected the Bank's liquidity (see Note 7).

The Bank's reserves as required by the BSP have been complied with and primary reserves are adequate to address substantial cash drawdown. The Bank has credit lines with different banks and it has huge liquid assets.

The Bank is exposed to daily calls on its available cash resources from savings deposits, maturing time deposits and loan drawdowns. The Bank maintains sufficient cash to cover withdrawals at unexpected levels of demand.

Operations Risk

Operational risk is the current and prospective risk to earnings or capital arising from fraud, error and the inability to deliver products or services, maintain a competitive position and manage information.

The Bank effectively implements the adequate policies and procedures governing operations. The Bank plans to outsource technical services on computer maintenance for its operations. The Bank is also adopting effective storage and back-up procedures for computer data.

Further, the Bank adopts good hiring policy with emphasis on minimum qualification and character and establishes a comprehensive scheme comparable with the industry taking into account a reward system for good performance. It also regularly reviews strict implementation and compliance of employee policies and sponsors employee development programs.

Market Risk

Market risk is the risk of loss to future earnings or capital arising from changes in the value of traded portfolios of financial instruments. The value of a financial instrument may change as a result of changes in interest rates, foreign exchange rates, equity prices and other market changes.

The Bank has set up parameters on investments based on a study of current economic and financial trend. The Bank also adopted a benchmark on the tolerance level on losses that should trigger an action by management on a particular investment and it has a constant oversight and monitoring of its own investments.

Interest Rate Risk

The Bank's exposure to the risk of changes in market interest rates relates primarily to due from other banks and unquoted debt securities classified as loans. Interest margin may increase or reduce as a result of such changes in market interest rates. The Bank monitors movements in market interest rates and reviews on monthly basis, interest rates of due from other banks and unquoted debt securities classified as loans.

The Bank has fixed its interest on loans and receivables and bills payable until maturity. It has not extended loans nor obtained loans with floating interest rates.

The tables illustrate the sensitivity of the Bank's profit with respect to changes in the interest rates of its due from other banks, including short-term investments, and unquoted debt securities classified as loan due to reasonably possible change in interest rates, with all other variables held constant:

	2018		
	Reasonably possible change in rate	**Effect on profit before tax**	**Effect on equity**
Due from other banks	+/- 1.64%	**₱ 698,276**	**₱ 698,276**
Unquoted debt securities classified as loans	+/- 1%	**19,500**	**19,500**
		₱ 717,776	**₱ 717,776**

	2017				
	Reasonably possible change in rate	Effect on profit before tax		Effect on equity	
Due from other banks	+/- 1.76%	₱	614,651	₱	614,651
Unquoted debt securities classified as loans	+/- 1%		19,500		19,500
		₱	634,151	₱	634,151

Foreign Currency Risk
The Bank has no exposure to foreign exchange rate risk since it has not entered into foreign exchange trading and most of its transactions are denominated in Philippine peso.

Compliance Risk
Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards.

The Bank has an Audit Committee which ensures that the compliance program and internal control systems are properly being implemented.

In compliance with Republic Act No. 9160, *Anti-Money Laundering Act of 2001*, the Bank implements its anti-money laundering (AML) program by implementing the following basic principles:

a. Know your Customer

   The Bank shall obtain satisfactory evidence of the customer's identity and have effective procedures for verifying the bonafides of new customers.

b. Compliance with Laws

   The Bank shall ensure that business is conducted in conformity with high ethical standards, that laws and regulations are adhered to, and that service is not provided where there is good reason to believe that transactions are associated with money laundering activities.

c. Cooperation with Law Enforcement Agencies

   Within the legal constraints in relation to customer's confidentiality, the Bank shall cooperate fully with law enforcing agencies. Disclosure of information by the Bank for the purpose of the Act regarding suspicious transactions shall be made to the Anti-Money Laundering Council of the Bangko Sentral ng Pilipinas.

d. Policies, Procedures and Training

   The Bank shall adopt policies consistent with principles set out in its Anti-Money Laundering Manual, and ensure that its staff, wherever located, are informed of these policies and adequately trained in matters covered by the Manual. The Bank shall implement specific procedures for customer identification, maintaining of transaction documents and reporting of covered and suspicious transactions.

29. Financial Instruments

Classification

Reconciliation of financial assets and financial liabilities based on their classifications to amounts is presented in the statement of financial position as follows:

	As of December 31, 2018			
	Loans and Receivables	Financial Assets at Cost	Non-Financial Assets	Total
ASSETS				
Cash and other cash items	₱ 7,071,057	₱ -	₱ -	**₱ 7,071,057**
Due from BSP	9,748,344	-		**9,748,344**
Due from other banks	49,697,101	-		**49,697,101**
Loans and receivables – net	309,186,518	-		**309,186,518**
Unquoted debt securities classified as loans		1,950,056		**1,950,056**
Investment properties	-	-	7,615,397	**7,615,397**
Bank premises, furniture, fixtures and equipment– net	-	-	10,391,886	**10,391,886**
Other intangible assets	-	-	873,001	**873,001**
Pension asset	642,644	-	-	**642,644**
Deferred tax assets	-	-	9,062,422	**9,062,422**
Other assets – net	4,172,180	-	2,248,696	**6,420,876**
Total	₱ 380,517,844	₱ 1,950,056	₱ 30,191,402	**₱ 412,659,302**

	As of December 31, 2018		
	Other Financial Liabilities	Non-Financial Liabilities	Total
LIABILITIES			
Deposit liabilities	₱ 234,320,737	₱ -	**₱ 234,320,737**
Bills payable	100,003,539	-	**100,003,539**
Accrued interest and other expenses	5,760,781	-	**5,760,781**
Income tax payable	61,342		**61,342**
Deferred tax liability	192,793	-	**192,793**
Other liabilities	-	2,599,874	**2,599,874**
Total	₱ 340,339,192	₱ 2,599,874	**₱ 342,939,066**

	As of December 31, 2017			
	Loans and Receivables	Financial Assets at Cost	Non-Financial Assets	Total
ASSETS				
Cash and other cash items	₱ 5,488,172	₱ -	₱ -	₱ 5,488,172
Due from BSP	8,535,382	-	-	8,535,382
Due from other banks	52,573,036	-	-	52,573,036
Loans and receivables – net	273,429,220	-	-	273,429,220
Unquoted debt securities classified as loans	-	1,950,056	-	-
Investment properties	-	-	4,962,299	4,962,299
Bank premises, furniture, fixtures and equipment– net	-	-	9,175,211	9,175,211
Other intangible assets	-	-	2,120,591	2,120,591
Deferred tax assets	-	-	9,060,497	9,060,497
Other assets – net	7,226,663	-	2,311,500	9,538,163
Total	₱ 347,252,473	₱ 1,950,056	₱ 27,630,098	₱ 376,832,627

	As of December 31, 2017		
	Other Financial Liabilities	Non-Financial Liabilities	Total
LIABILITIES			
Deposit liabilities	₱ 294,090,956	₱ -	₱ 294,090,956
Bills payable	57,086,250		57,086,250
Accrued interest and other expenses	3,361,120	-	3,361,120
Accrued retirement liability	455,164		455,164
Income tax payable	2,397,714	-	2,397,714
Other liabilities		2,809,910	2,809,910
Total	₱ 312,391,474	₱ 2,809,910	₱ 315,201,384

Fair values of financial instrument

Fair value is defined as the amount at which the financial instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than a forced liquidation or sale. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models as appropriate.

Valuation techniques and assumptions applied for purposes of measuring fair value

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

a. Cash and other cash items, due from BSP and other banks and other assets

   Fair values approximate carrying amounts given the short-term maturities of these instruments.

b. Loans and receivables

   The estimated fair value of loans and receivables represent the amortized cost determined using the effective interest method.

c. Bills payable

   The estimated fair value of bills payable represents the discounted amount of estimated future cash flows expected to be paid. Expected cash flows are discounted at current market rates to determine fair value.

d. Deposits and borrowings

   The estimated fair value of demand deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.

   The estimated fair value of the long-term fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flow using interest for new debts with similar remaining maturity.

30. Events after the Reporting Period

Financial Statements Authorized for Issue

The financial statements as of and for the year ended December 31, 2018 were approved and authorized for issuance by the Board of Directors on March 14, 2019.

SOUTH BANK (A RURAL BANK) INCORPORATED
FINANCIAL INDICATORS
DECEMBER 31, 2018 AND 2017

	2018	2017
Quick ratios	1.61	1.36
Current/Liquidity ratios	1.61	1.36
Debt-to-equity ratios	4.92	5.11
Debt-to-asset ratios	0.83	0.84
Equity-to-asset ratios	0.17	0.16
Return on assets	0.02	0.01
Return on equity	0.11	0.13
Times interest earned	1.94	2.15

SOUTH BANK (A RURAL BANK) INCORPORATED
OTHER FINANCIAL INFORMATION
DECEMBER 31, 2018 AND 2017

	2018	2017
Investment properties-to-asset ratios (Including ROPA)	0.02	0.01
Investment properties-to-asset ratios (Excluding ROPA)	0.00	0.00
Receivables-to-asset ratios	0.75	0.73
DOSRI receivables-to-net worth ratio	0.81	0.77