Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines
Corporate Government Sector
Cluster 1 – Banking and Credit

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Philippine Postal Savings Bank, Inc.
Liwasang Bonifacio, Manila

We have audited the accompanying consolidated financial statements of **Philippine Postal Savings Bank, Inc.**, which comprise the statements of financial position as at December 31, 2016 and 2015, and statements of comprehensive income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Basis for Qualified Opinion

Provision for credit losses of secured/unsecured past due loans which were of doubtful collectability amounting to P390.332 million was not recognized in 2016. Had the provision for credit losses been recognized in 2016, loans and receivable account and income for the year would have been decreased by P390.332 million.

Qualified Opinion

In our opinion, except for the effects of the matter discussed in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, the financial position of **Philippine Postal Savings Bank, Inc**. as at December 31, 2016 and 2015, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

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

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 19-2011 and 15-2010 in Note 25 to the financial statements is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the Management of the **Philippine Postal Savings Bank, Inc.** The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

COMMISSION ON AUDIT

By:

ROSALINDA T. SILAGAN
State Auditor IV
OIC, Supervising Auditor

May 18, 2017

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of **Philippine Postal Savings Bank, Inc.** is responsible for the preparation and fair presentation of the financial statements for the year(s) ended **December 31, 2016 and 2015**, in accordance with the prescribed financial reporting framework indicated therein. This responsibility includes designing and implementing internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

The Board of Directors or Trustees reviews and approves the financial statements and submit the same to stockholders or members.

The **Commission on Audit (COA)**, the independent auditors, appointed by the stockholders has examined the financial statements of the company in accordance with Philippine Standards on Auditing, and in its report to the stockholders or members, has expressed its opinion on the fairness of presentation upon completion of such examination.

CESAR N. SARINO
Chairman of the Board
President and Chief Executive Officer

PATRIA P. MADRIO
Head, Administrative and Comptrollership Group

February 17, 2017

PART I – AUDITED FINANCIAL STATEMENTS

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENTS OF FINANCIAL POSITION
December 31, 2016 and 2015
(In Philippine Peso)

	Note	2016	2015 As restated
ASSETS			
Cash and cash equivalents	6	97,919,576	107,039,280
Due from Bangko Sentral ng Pilipinas	7	1,849,700,615	2,658,121,435
Due from other banks	8	2,731,871,060	2,611,314,931
Loans and receivables - net	9	5,535,735,961	6,114,168,687
Loans and receivables arising from RA/CA/PR/SLB	10	78,892,402	0
Held for trading financial assets	11	48,529,195	0
Available for sale financial assets	12	547,538,108	22,437,127
Unquoted debt securities classified as loans	13	50,085,797	60,266,452
Bank premises, furniture, fixtures and equipment - net	14	197,632,266	196,767,537
Non-Current assets held for sale	15	41,000,328	41,198,221
Investment Property - net	16	220,189,010	71,764,930
Sales contract receivable	17	34,465,101	32,272,651
Other asset - net	18	164,408,872	157,063,685
TOTAL ASSETS		**11,597,968,291**	**12,072,414,936**
LIABILITIES AND EQUITY			
Deposit liabilities	19	9,723,641,069	10,765,261,084
Bills payable	20	650,000,000	0
Manager's/Cashier's checks		16,309,768	19,097,299
Unearned income and other deferred credits		50,554,215	42,524,388
Accrued taxes and other expenses	21	66,072,404	106,687,323
Special time deposit		40,000,000	40,000,000
Other liabilities	22	69,623,409	86,672,564
TOTAL LIABILITIES		10,616,200,865	11,060,242,658
EQUITY			
Capital stock	23	820,242,883	800,242,883
Other comprehensive income (loss)		-36,087,676	2,409,804
Retained earnings unappropriated	25	197,612,219	209,519,591
TOTAL EQUITY		981,767,426	1,012,172,278
TOTAL LIABILITIES AND EQUITY		**11,597,968,291**	**12,072,414,936**

The Notes on pages 8 to 38 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31, 2016 and 2015
(In Philippine Peso)

	Note	2016	2015 As restated
INTEREST INCOME			
Interest/discount earned on loans & discounts		511,510,789	550,648,583
Interest on investments		11,505,296	9,735,682
Interest income - loans and receivables arising from RA/CA/PR/SLB		1,687,759	-
Interest on due from Bangko Sentral ng Pilipinas		34,827,568	44,895,023
Interest on deposits with banks		26,550,320	17,775,448
Interest income on sales contract receivable		3,609,543	3,276,743
Others		193	131
		589,691,468	626,331,610
INTEREST EXPENSE			
Interest on deposit liabilities		148,168,713	135,532,671
Provision for losses on accrued interest income		7,692,706	1,109,476
		155,861,419	136,642,147
NET INTEREST INCOME		433,830,049	489,689,463
OTHER INCOME			
Fees and commission income		28,684,700	26,579,472
Gain/loss from sale/derecognition of non-financial assets		6,169,379	6,061,582
Gain on financial assets and liabilities held for trading		450,917	29,329
Gain from sale/redemption/derecognition of non-trading financial assets & liabilities		5,898,334	29,515,001
Foreign exchange (loss)/gain		(10,863)	68,836
Recovery on charged-off assets		570,604	1,395,763
Miscellaneous income	27	52,256,500	59,260,231
		94,019,571	122,910,214
OPERATING EXPENSES	28	534,830,883	500,850,155
NET INCOME BEFORE TAX		-6,981,263	111,749,522
PROVISION FOR INCOME TAX		4,926,109	45,619,430
NET INCOME AFTER TAX		-11,907,372	66,130,092
OTHER COMPREHENSIVE INCOME (LOSS)			
Unrealized loss on Available for sale financial assets	24	-38,497,480	-32,444,022
TOTAL COMPREHENSIVE INCOME (LOSS)		-50,404,852	33,686,070

The Notes on pages 8 to 38 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENTS OF CHANGES IN EQUITY
December 31, 2016 and 2015
(In Philippine Peso)

Note	Capital Stock 23	Other Comprehensive Income	Retained Earnings Unappropriated 25	Total Equity
Balance January 1, 2015 before restatement	**800,242,883**	**34,853,826**	**143,279,499**	**978,376,208**
Issuance of capital stock	0			0
Unrealized loss on Available for sale financial assets		-32,444,022		-32,444,022
Prior period adjustments			110,000	110,000
Balance, January 1, 2015 as restated	800,242,883	2,409,804	143,389,499	946,042,186
Net income, 2015 before restatement			134,706,052	134,706,052
Net adjustments			-68,575,960	-68,575,960
Net income, 2015 as restated			66,130,092	66,130,092
Balance, December 31, 2015 as restated	**800,242,883**	**2,409,804**	**209,519,591**	**1,012,172,278**
Issuance of capital stock	20,000,000			20,000,000
Unrealized loss on Available for sale financial assets		-38,497,480		-38,497,480
Net income, 2015			-11,907,372	-11,907,372
Balance, December 31, 2016	**820,242,883**	**-36,087,676**	**197,612,219**	**981,767,426**

The Notes on pages 8 to 38 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2016 and 2015
(In Philippine Peso)

	Note	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Deposit/(withdrawals) by clients		(1,041,620,015)	2,808,818,207
Interest income, fees and commission received		683,618,255	750,887,634
Release/collection of loans and receivables		328,344,839	(881,065,411)
Fund advances to customers and employees		(956,681)	(832,633)
Profit from sale/redemption of investments		5,898,334	29,515,001
Recoveries on loans previously written off		570,604	1,395,763
Income from assets held for trading		450,917	29,329
Proceeds from BSP for regulatory or monetary control purposes		808,420,820	250,096,915
Deposits to other banks		(120,556,130)	(2,494,678,098)
Cash payments to suppliers		(180,688,547)	(245,076,815)
Cash payments to employees		(229,138,878)	(191,549,150)
Interest and finance charges		(151,453,901)	(131,107,293)
Prepaid taxes, licenses and other expenses		(467,363)	(9,021,254)
Cleared/returned checks and other cash items		(118,581)	5,667,675
Payment of/proceeds from sale of financial assets		(691,020,058)	78,408,591
Payments/proceeds of unidentified cleared checks		549,718	(173,656)
Payment of taxes		(61,526,946)	(64,948,353)
Collection of directors' disallowances and other expenses		110,000	2,817,555
Payment of litigation/asset acquired expenses		(3,861,660)	(3,493,793)
Transfer of funds from regional branches		(2,323,755)	(5,474,314)
Proceeds of short term borrowings		650,000,000	0
Net cash used in operating activities		(5,769,028)	(99,784,100)
CASH FLOWS FROM INVESTING ACTIVITIES			
Sale of unquoted debt securities classified as loans		10,180,655	36,889,877
Rental income		16,951	6,845
Acquisition of property and equipment		(39,706,798)	-2,383,466
Collection of sales contract receivables		6,169,379	6,061,582
Net cash used/provided by investing activities		-23,339,813	40,574,838
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds of long term borrowings		0	40,000,000
Issuance of common shares		20,000,000	0
Net cash provided by financing activities		20,000,000	40,000,000
Effects of exchange rate changes on cash and cash equivalents		-10,863	68,836
NET DECREASE IN CASH AND CASH EQUIVALENTS		**-9,119,704**	**-19,140,426**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	6	**107,039,280**	**126,179,706**
CASH AND CASH EQUIVALENTS AT END OF YEAR	6	**97,919,576**	**107,039,280**

The Notes on pages 8 to 33 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Wholly Owned Subsidiary of the Philippine Postal Corporation)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts rounded off in Peso except when otherwise stated)

1. GENERAL INFORMATION

Philippine Postal Savings Bank, Inc. (PPSBI) is a subsidiary of the Philippine Postal Corporation (PPC) re-established and re-opened by virtue of PPC Board Resolution No.94-34 dated February 24, 1994 in fulfillment of the intents and purposes of R.A. No. 7354, otherwise known as Postal Service Act of 1992, which was enacted by the Congress on April 03, 1992. The re-establishment of PPSBI was finally approved under the Bangko Sentral ng Pilipinas Board Resolution No. 267 dated March 18, 1994. The Bank was incorporated on June 22, 1994 and started operations as a savings and mortgage bank on July 21, 1994. As stated in its Vision/Mission: "The Bank shall mobilize savings and promote entrepreneurship to widen economic opportunities and to provide the Filipino people with a full range of professional banking and financial resources accessible in all areas of the country, and shall promote the values of thrift, industry and prudence especially in the youth."

Its principal place of business is at Liwasang Bonifacio, Intramuros, Manila.

As of December 31, 2016, the Bank had 473 employees and operated twenty five (25) branches and six (6) Micro Banking Offices (MBO), namely:

Northern Luzon Area:

1. Tuguegarao, Cagayan Branch
2. Baguio Branch
3. Asingan, Pangasinan Branch
4. Dagupan, Pangasinan Branch
5. San Fernando, La Union Branch
6. Tarlac Branch

4.1. MBO Binmaley
4.2. MBO Mapandan

Metro Luzon Area:

1. Head Office-Liwasang Bonifacio, Manila
2. Mabalacat, Pampanga Branch
3. Malolos, Bulacan Branch
4. San Pablo, Laguna Branch
5. Lipa City, Batangas Branch

Southern Luzon Area:

1. Naga, Camarines Sur Branch
2. Tigaon, Camarines Sur Branch
3. Legaspi. Albay Branch
4. Sorsogon Branch

1.1. MBO Bula
1.2. MBO Bombon
3.1. MBO Bacacay
3.2. MBO Malinao

Visayas Area:

1. Tacloban, Leyte Branch
2. Tagbilaran, Bohol Branch
3. Iloilo Branch
4. Himamaylan, Negros Occidental Branch
5. Cebu Branch
6. Bacolod Branch

Mindanao Area:

1. Davao Branch
2. Zamboanga Branch
3. Cagayan de Oro Branch
4. Manolo Fortich, Bukidnon Branch

In December 2016, the National Government directed the Land Bank of the Philippines to initiate the acquisition of Postbank as its subsidiary, with the plan of eventually converting it to a Bank for Overseas Filipino Workers (OFWs).

The said plan was also made public via pronouncements in major broadsheets by the Secretary of Finance.

This paved way for the conduct of due diligence on bank operations which started January 2017 and preliminary discussions between Land Bank of the Philippines (LBP) and Postbank officials to implement the government's directive.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Financial Statement Preparation

The Bank's consolidated financial statements have been prepared in accordance with the applicable accounting principles generally accepted in the Philippines and as set forth in the Philippine Financial Reporting Standards/Philippine Accounting Standards (PFRS/PAS). These financial statements are prepared on historical cost basis modified by the fair value measurement of financial assets on Available for Sale Securities. The accompanying financial statements of the Bank reflect the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU).

The preparation of financial statement requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies.

The accounting policies adopted are consistent with those of the previous years.

Financial statements are presented in Philippine peso, which is the functional and presentation currency.

2.2 Foreign Currency Translation

Foreign currency transactions are accounted for and revalued monthly using the month-end Philippine Dealing and Exchange System (PDEX) closing rate. Foreign exchange differences arising from the revaluation are charged to operations.

2.3 Cash and Other Cash Items

For purposes of presentation in the consolidated statement of cash flows, Cash and other cash equivalents consist of cash and other cash items on hand.

2.4 Due From Other Banks

This account refers to the balances of funds deposited with other local banks to meet not only reserve requirements but also to cover operational requirements including payroll and tax requirements.

2.5 Financial Assets/Liabilities

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Deposits, amounts due to banks and customers and loans are recognized when cash is received or released to the borrowers.

In accordance with PAS 39-Financial Assets – Recognition and Measurement, the Bank's financial assets or financial liabilities are recognized initially at fair value. Subsequent to initial recognition, we continue to measure at fair value except for the loans and receivables, which are measured at amortized cost using the diminishing balance method. Gains and losses arising from changes in the fair values of available for sale financial assets are recognized directly in the equity until the financial asset is derecognized or impaired at which time the cumulative gain or loss previously recognized in equity should be recognized in profit or loss statement. Gain or loss arising from the change in fair value of Unquoted Debt Securities Classified as Loans and Held to Maturity Financial assets are recognized in profit or loss when the security is derecognized or impaired, and through the amortization process.

The Bank classifies its financial assets under the following categories:

a. Financial Assets Available for Sale (AFS)

Available for sale investments are those purchased and held indefinitely, which may be sold in response to liquidity needs or changes in interest rates, exchange rates or equity prices.

b. Financial Assets – Held to Maturity (HTM)

These are debt securities, quoted in an active market with fixed or determinable payments and fixed maturity for which the Bank has the positive intention and ability to hold until maturity.

c. Unquoted Debt Securities Classified as Loans

These are debt securities with fixed or determinable payments that are not quoted in an active market.

d. Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: a) those that the bank intends to sell immediately or in the near term, which shall be classified as Held for Trading (HFT) and those that the entity upon initial recognition designates as at fair value through profit or loss; b) those that the Bank designates as AFS upon initial recognition; or c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as AFS.

Regular loans (Loans to Gov't, Agri-Agra, Development. Incentive, SME and microfinance, contract to sell and others) are carried in the books at its amortized cost or the amount at which the financial asset is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the diminishing balance method, minus any reduction –directly or through the use of an allowance account – for impairment or uncollectibility.

There are fees and other charges that are recognized immediately as income upon collection except for the advance interests, which are booked under Unearned Income account. Starting July 2014, the Bank started to use the Effective Interest Rate Method of calculating interest on new loans releases. Transactions costs were amortized over the life of the loan.

Past due loans and receivables are automatically carried on non-accrual basis. Interest incomes on such accounts are recognized only upon collection.

Unclassified Loans are loans that do not have a greater-than normal risk and do not possess the characteristics of classified loans as defined below:

a. Loans or portions thereof secured by holdouts on deposit/deposit substitutes maintained in the lending institution and margins deposits, or government-supported securities; and

b. Loans with technical defects and deficiencies in documentation and/or collateral requirements. These deficiencies are isolated cases where the exception involved are not material nor is the Bank's chance to be repaid or the borrower's ability to liquidate the loan in an orderly manner undermined. These exceptions should be brought to management's attention for corrective action during the examination and those which are not corrected shall be included in the Report of Examination under "Miscellaneous Exceptions – Loan". Moreover, deficiencies which remained uncorrected in the following examination shall be classified as "Loans Especially Mentioned".

Classified Loans are loans which possess the characteristics outlined hereunder:

a. Loans Especially Mentioned are loans and advances that have potential weaknesses that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the loan and thus increase credit risk to the Bank.

b. Substandard are loans or portions thereof which appear to involve a substantial and unreasonable degree of risk to the institution because of unfavorable record or unsatisfactory characteristics. There exists in such loans the possibility of future loss to the institutions unless given closer supervision. Those classified as "Substandard" must have a well-defined weakness or weaknesses that jeopardize their liquidation. Such well-defined weaknesses may include adverse trends or development of financial, managerial, economic or political nature, or a significant weakness in collateral.

c. Doubtful Loans are loans or portion thereof which have the weaknesses inherent in those classified as "Substandard", with the added characteristics that existing facts, conditions, and values make collection or liquidation in full highly improbable and in which substantial loss is probable.

d. Loss are loans or portions thereof which are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted although the loans may have some recovery or salvage value. The amount of loss is difficult to measure and it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be obtained in the future.

Loan Loss Estimation Methodology, Provisioning and Allowance for Credit Losses:

a. All FIs shall develop and document a sound loan loss methodology that can reasonably estimate provisions for loans and other credit accommodations and risk assets in a timely manner, using their experience and research and this guidance to ensure that the specific and collective allowance for credit losses (ACL) are adequate and approximates the expected losses in their credit portfolio.

An FI's loan loss methodology shall consider the following:

a.1. Written policies and procedures for the credit risk systems and controls inherent in the methodology, including roles and responsibilities of the FI's board of directors and senior management;

a.2. A detailed analysis of the entire loan portfolio, including off-balance sheet facilities, performed on a regular basis;

a.3. A realistic view of its lending activities and uncertainty and risks inherent in those activities in preparing accounting information. Loan accounting policies and practices shall be selected and applied in a consistent way that reasonably assures that loan and loan loss provision information is reliable and verifiable;

a.4. Identification of loans to be evaluated individually and segmentation of the remaining portfolio into groups of loans with similar credit risk characteristics for collective assessment.

a.4.a. Individually assessed loans. FIs shall establish a materiality threshold for significant credit exposures that will warrant an individual assessment, which threshold shall be regularly reviewed.

The loan loss estimates shall reflect consideration of the facts and circumstances that affect the repayment of each individual loan as of the evaluation date. The following factors are relevant in estimating loan losses for individually assessed loans:

a.4.a.1. Significant financial difficulty of the borrower;

a.4.a.2. Probable bankruptcy or other financial reorganization of the borrower;

a.4.a.3. Breach of contract, such as a default or delinquency in interest or principal payments; or

a.4. a.4 Concession granted by the FI, for economic or legal reasons relating to the borrower's financial difficulty, which would not otherwise be considered.

The methodology shall include procedures describing the determination and measurement of the amount of any impairment, the impairment measurement techniques available and steps performed to determine which technique is most appropriate in a given situation.

a.4.b. Collectively assessed loans. FIs may use different methods to group loans for the purpose of assessing credit risk and valuation. More sophisticated credit risk assessment models or methodologies for estimating expected future cash flows, including credit risk grading processes, may combine several of the following characteristics: loan type, product type, market segment, estimated default probabilities or credit risk grading and classification, collateral type, geographical location and past-due status.

Estimated credit losses shall reflect consideration of the FI's historical net charge-off rate of the groups, adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans in these groups as of the evaluation date, and applied consistently over time;

a.4.b1. Methods used to determine whether and how loans individually evaluated, but not considered to be individually impaired, shall be grouped with other loan (excluding individually assessed loans that are impaired) that share similar credit risk characteristics for collective impairment evaluation;

a.4.b.2. The quality and net realizable values of physical collateral and other financial guarantees and credit risk mitigants incorporated in the loan agreement, where applicable;

a.4.b.3. Address the methods used to validate models for credit risk assessment;

a.4.b.4 The analyses, estimates, reviews and other provisioning methodology functions shall be performed by competent and well-trained personnel and be well documented, with clear explanations of the supporting analyses and rationale; and

a.4.b.5. Use experienced credit judgment. Assessment of expected losses shall not be based solely on prescriptive rules or formula but must be enhanced with experienced credit judgment by the appropriate levels of management in as much as historical loss experience or observable data may be limited or not fully relevant to current circumstances. However, the scope for actual discretion shall be prudently within the following constraints:

a.4.b.5.a. Experienced credit judgments shall be subject to established policies and procedures;

a.4.b.5.b. With approved and documented analytical framework for assessing loan quality applied consistently over time; Estimates shall be based on reasonable and verifiable assumptions and supported by adequate documentation; and

a.4.b.5.c. Assumptions concerning the impact on borrowers of changes in general economic activity, both favorable and unfavorable, shall be made with sufficient prudence.

The method of determining loan loss provisions shall reasonably assure the timely recognition of loan losses. While historical loss experience and recent economic conditions are a reasonable starting point for the institution's analysis, these factors are not, by themselves, sufficient basis to determine the appropriate level of aggregate loan loss provisions. Management shall also consider any current factors that are likely to cause loan losses to differ from historical loss experience, including changes in the following:

a. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices;

b. International, national and local economic and business conditions and developments, including the condition of various market segments;

c. Trend, volume and severity of past due loans and loans graded as low quality, as well as trends in the volume of impaired loans, troubled debt restructurings and other loan modifications;

d. The experience, ability, and depth of lending management and staff;

e. Changes related to new market segments and products;

f. Quality of the FI's loan review system and the degree of oversight by senior management and board of directors;

g. The existence and effect of any concentrations of credit, and changes in the level of such concentrations; and

h. Credit risk profile of the loan portfolio as a whole as well as the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the FI's current portfolio.

Experienced credit judgment shall also be used to determine an acceptable period that will yield reliable historical loss rates as loss rate periods shall not be restricted to a fixed time period to determine the average historical loss experience for any group of loans with similar credit risk characteristics.

An FI shall maintain sufficient historical loss data over a full credit cycle to provide robust and meaningful statistical loan loss estimates for establishing the level of collective impairment losses for each group of loans with similar credit risk characteristics. When applying experienced credit judgment, an FI shall provide a sound rationale for excluding any historical loss data that is deemed not representative of the performance of the portfolio.

b. FIs with credit operations that may not economically justify a more sophisticated loan loss estimation methodology or whose practices fell short of expected standards shall, at a minimum, be subject to the regulatory guidelines in setting up allowance for credit losses prescribed in *Appendix 18 of Manual of Regulations for Banks (MORB): Provided*, that the FIs notify the Bangko Sentral, through their respective Central Points of Contact, of this preference. Nevertheless, such FIs shall still use experienced credit judgment, subject to the criteria prescribed in this Subsection, in determining the ACL.

c. FIs shall set up general loan loss provision equivalent to one percent (1%) of the outstanding balance of individually and collectively assessed loans for which no specific provisions are made and/or for which the estimated loan losses are less than one percent (<1%), less loans which are considered non-risk under existing laws, rules and regulations.

d. FIs shall ensure the adequacy of the individual and collective ACL for the entire loan portfolio. They shall have a policy for the regular review of the ACL, which shall be conducted at least semi-annually after considering results of the credit review, level of classified loans, delinquency reports, historical losses and market conditions.

Failure to make adequate provisions for estimated future losses results in material misrepresentation of a FI's financial condition.

As a general rule, past due accounts shall refer to all accounts of the Bank under its loan portfolio which are not paid at maturity.

a. The following shall be considered as past due:

a.1. Loan receivable payable on demand not paid on the date indicated on the demand letter, or within three months from the date of grant, whichever comes earlier;

a.2. Bills discounted and time loans, whether or not representing availments against a credit line, not paid on the respective maturity dates of the promissory notes;

a.3. Bills and other negotiable instruments purchased, if dishonored upon presentment for acceptance/payment or not paid on maturity date, whichever comes earlier: provided, however, that an out-of-town check and a foreign check shall be considered as past due if outstanding for 30 days and 45 days, respectively, unless earlier dishonored; and

a.4. Loans or receivables payable in installments where the number of installment in arrears fall under the following:

Mode of Payment	Minimum No. of Installment in Arrears
Monthly	3
Quarterly	1
Semestral	1
Annual	1

Provided, however, that when the total amount of arrearages reaches 20 per cent of the total outstanding balance of the loan/receivable, the total outstanding balance of the loan/receivable shall be considered as past due, regardless of the number of installment in arrears.

Provided, further, that for modes of payment other than those listed above (e.g., daily, weekly, semi-monthly), the entire outstanding balance of the loan/receivable shall be considered as past due when the total amount of arrearages reaches 10 percent of the total loan/receivable balance.

b. Reclassification of loan accounts to past due status shall be effected on the banking day immediately following the date when any of the preceding conditions has been reached. In determining the total number of days past due, the relevant time period is reckoned as follows:

Payment Type	Reclassification date
Lump sum (single) payment	From maturity date to payment date
Amortized	From date of first default to payment date

c. If a borrower has past due obligations, the Bank may declare the borrower's other current obligation as due and demandable.

d. The decision to proceed with the collection of outstanding obligations in current status as well as the suspension of credit lines shall rest with the same approving authority which approved the loan.

e. When the account turned past due, real estate tax and insurance premium shall be updated by the lending unit concerned if the client fails to pay such obligations.

f. A grace period of 30 days is given to clients after the due date where no penalty charges shall be imposed.

g. Past due interest shall be computed on loans considered past due. Interest on past due loans (amortized) before the maturity date shall be computed as is using the interest rate indicated in the PN. Interest on the past due loans after the maturity date shall be computed using the interest rate indicated in the PN or the prevailing interest rate at the time of payment, whichever is higher.

h. Penalty charge shall be computed on delayed amortization or, in case of past due accounts, on outstanding balance. Amortization shall mean principal and/or interest payment. When the payment due date falls on a Saturday, Sunday or a non-working holiday, payment made on the next banking days shall be deemed to have been received on the original due date. No penalty charges shall be imposed accordingly.

2.6 Sales Contract Receivable

These are receivables from assets acquired in settlement of loans through foreclosure or dation in payment and subsequently sold on installment basis whereby the title to the said properties are transferred to the names of the respective buyers only upon full payment of the agreed selling price. These are recorded initially at the value of the installment receivables due from borrower. Discounts are accreted over the life of the SCR by crediting interest income. Any difference between the present value of the SCR and the derecognized assets shall be recognized in profit or loss at the date of sale in accordance with the provisions of PAS 18.

2.7 Impairment

A financial asset is impaired if its carrying cost less allowance for losses exceeds its recoverable values. Recoverable amount is the higher of its fair market value less cost to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from an asset. Impairment losses are recognized in the books only if there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset that can be reliably measured/estimated. The carrying amount of the asset is also reduced through the use of an allowance account. The amount of the impairment loss is recognized in the income statement.

Uncollectible loans are written off against the related allowance account for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of loss has been determined. Subsequent recoveries of amounts previously written off are recognized as deductions to provisions in the income statement.

If in a subsequent period, the amount of the recognized impairment loss decreases, and the decrease can be related objectively to an event after the impairment was recognized, the previously recognized impairment loss is reversed by adjusting the allowance account and the amount of reversal is recognized in the income statement.

In case of Investment property, Bank Premises, Furniture, Fixtures and Equipment (BPFFE) and other assets, impairment loss is the difference between the carrying amount and the fair value less cost to sell in case carrying amount is higher. The loss is recognized in the income statement and an allowance account is set up to reduce the carrying amount of the asset.

2.8 Bank Premises, Furniture, Fixtures and Equipment

Bank premises, furniture, fixtures and equipment including leasehold improvements are stated at cost less accumulated depreciation and amortization and any impairment in value. Depreciation is computed based on a straight-line method net of ten percent residual value of acquisition cost over the estimated useful lives of the related assets as follows:

Building	10-20 years	
Furniture and Fixtures	5-10 years	
Equipment	5 years	
Leasehold Improvements	5 years	(maximum)

Impairment is only recognized when there is substantial evidence of the decline in the value of the bank premises, furniture, fixtures and equipment.

The cost of leasehold improvements is amortized over the term of the lease or the estimated useful life of the improvements not exceeding 5 years whichever is shorter. Minor expenditures for replacement, maintenance and repairs are expensed as incurred. Major renovations and improvements that will extend the life of the asset are capitalized.

Properties that are no longer needed or uneconomical to maintain are disposed of in accordance with the existing guidelines on disposal. The cost and the related accumulated depreciation and amortization of the disposed assets are derecognized from the books and any resulting gain or loss is credited or charged to current operations.

2.9 Non-Current Assets Held for Sale

The Bank classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. The asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. For the sale to be highly probable the appropriate level of management is committed to a plan to sell the assets and an active program to locate a buyer and the plan has been initiated. Further, the assets are actively marketed for sale at a price that is reasonable in relation to its current fair value. Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset from being classified as held for sale if the delay is caused by events or circumstances beyond the Bank's control and there is sufficient evidence that the Bank remains committed to its plan to sell the asset.

Non-current assets classified as held for sale should be measured at the lower of its carrying amount and fair value less cost to sell. The Bank shall recognize an impairment loss for any initial or subsequent write-down of the asset to fair value less cost to sell.

2.10 Investment Property

These are generally land and buildings acquired by the Bank either through foreclosure (legal proceedings initiated by the Bank to acquire the collateral securing the loan of the defaulting borrowers) or dacion en pago in settlement of loans and advances of defaulting borrowers, or assets acquired through the implementation of an execution of attachment of real properties in settlement of the Bank's deficiency claims against defaulting borrowers (legal proceedings initiated by the Bank in case there are still deficiency claims after all the underlying collaterals of the borrowers were judicially/extra-judicially acquired by the Bank). These assets are being held until such time that these are readily available for disposition and are reclassified to Non-Current Assets Held for Sale.

Expenditures such as repairs and maintenance are charged against operations in the year 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 acquired assets beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of acquired assets held for sale.

2.11 Leases

The leases entered into by the bank are primarily operating leases. The payments made under operating leases are recognized as an expense on a straight-line basis over the period of the lease. The Bank leases the premises of its 3 branches (Cagayan de Oro, Baguio and Dagupan) from Philippine Postal Corporation, its mother corporation, for periods ranging from five to ten years renewable upon mutual agreement of both parties. The costs of renovations effected by the bank on PPC premises are charged against future rentals payable.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized as an expense in the period in which termination takes place.

2.12 Intangible Assets

Intangible assets represent costs of software licenses and cost incurred directly in the development and maintenance. These are measured at cost and amortized based on a straight-line method with an expected maximum useful life of 10 years. Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred. Cost that are directly associated with the production of identifiable and unique software products controlled by the bank and that will probably generate economic benefits exceeding costs, beyond one year, are recognized as intangible assets. Direct costs include software licenses, software development, employee costs and the related overheads.

2.13 Deferred Tax Asset

Deferred tax assets are the amount of income taxes recoverable in future periods, which are recognized for all deductible temporary differences.

2.14 Recognition of Income and Accounting for Expenses

Interest, other income and expenses are recognized on accrual basis, except for those loan accounts, which are adversely classified consistent with the guidelines of the BSP.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The following are the critical judgments and key assumptions that have significant influence in the carrying amounts of assets and liabilities:

3.1 Impairment losses of loans and receivables

The Bank reviews its loan portfolio to assess impairment at least annually or as the need arises. In determining whether an impairment loss should be recorded in the books, the Bank makes judgment as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows including information indicating that there has been an adverse change in payment status of borrowers, or national or local economic conditions that correlate with defaults on assets.

3.2 Impairment of AFS investments

The Bank considers AFS investments as impaired when there has been a significant or prolonged decline in fair value (market value) below its carrying amount. The determination of what is significant or prolonged decline in fair value requires judgment. In making this judgment, the Bank evaluates among other factors, the normal volatility in prices. Impairment may also be appropriate when there is evidence of deterioration in the financial health of the Investee Company, industry and sector performance, changes in technology and operational and financing cash flows.

3.3 Held to Maturity Financial Assets

The Bank follows the guidelines of PAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as HTM. This classification requires significant judgment for the Bank in evaluating its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than in certain specific circumstances, the Bank will be required to reclassify the entire portfolio as AFS. The investments would therefore be measured at fair value and not at amortized cost.

3.4 Impairment of Bank Premises, Furniture, Fixtures and Equipment /Other Assets

Assets are reviewed and tested whenever there is indication of impairment at least annually. Impairment of assets requires estimates and judgments through the use of certain tools/devices/factors/market data.

4. FAIR VALUES OF FINANCIAL ASSETS & LIABILITIES

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

4.1 For debt securities, its fair values are generally based upon quoted market prices. If the market prices are not readily available, fair values are estimated using either value obtained from independent parties offering pricing services or adjusted quoted market prices of comparable investments.

4.2 For short-term investments, carrying amounts approximate fair values.

4.3 For other financial assets and financial liabilities with quoted market prices not readily available, they are reported at cost.

4.4 For Cash and cash equivalents, carrying amounts approximate fair values.

5. MANAGEMENT OF RISKS RELATED TO FINANCIAL INSTRUMENTS

The Bank has established risk management systems to address the risks inherent to its activities which include, among others, credit, market, liquidity, foreign currency, and interest rate risks.

Decisions in relation to risk management are made by the Risk Management Committee (RMC), which ensures effective monitoring and control over risks being taken. The committee, together with the Risk Officer, is responsible for the development, implementation, maintenance, improvement and communication of the risk management policy while each business and supporting unit has the primary task of managing the risks applicable to its area of responsibility.

Overall Risk Management Philosophy

Postbank considers sound and adequate risk management as critical component of a stable and profitable financial institution. Risk is an inherent part of its business undertakings - present in the financial instruments it acquires and trades, in loans it grants, in deposits it generates to fund its requirements, and even in people it hires - it is imperative that risk-related issues are taken into consideration in all its business decisions and communicated across the Bank starting from the Board of Directors to Senior Management down to actual risk-taking units through a well-defined risk system and structure. A sound corporate risk management philosophy translates into prudent risk-taking and proactive portfolio management enabling Postbank to pursue its financial expansion while maintaining adequate capital at all times.

Risk Management System and Structure

The risk management framework at Postbank is a top-down process where all risk policies and procedures are approved by the Board of Directors (BOD). The Board sets the overall risk tolerance of the Bank that is consistent with its business plan, financial strength and organizational capability.

BOD has created the Corporate Governance and Risk Management Committee (CGRMC), composed of 5 members of the Board, to oversee the implementation of risk management process that includes development of various risk strategies and principles, implementation of risk measurement tools, monitoring risk indicators and approval of risk limits.

The **Risk Management Office** (RMO) is the direct support of the CGRMC in the day-to-day identification, measurement, monitoring and control of risks. As an independent unit reporting directly to the Board, RMO consults with business units in identifying, measuring, and implementing risk management methodologies and controls. It assists business and operating units in measuring risk/return to better manage their risk profile. The **Senior Management** of Postbank is also actively involved in the planning, reviewing and assessing different risks being managed by the Bank through the various committees. The Management Committee (Mancom) ensures that all business objectives are aligned with the risk tolerance set by the Board. The **Assets and Liabilities Management Committee** (ALMC) is responsible for ensuring market and liquidity risks are adequately addressed on long-term and daily basis. The **Lending Committee** (LendCom) which has been delegated with credit authority limits, reviews, approves/ recommends loan proposals and credit policies to the Board.

Internal Audit Group provides another layer for independent check and balance to further strengthen risk controls and compliance. Internal Audit ensures that risk-takers comply with standards and established policies. It also evaluates the effectiveness and adequacy of the Bank's risk management framework particularly on its control processes.

Legal Group has the primary responsibility of reviewing all Bank's documents for completeness and enforceability under respective legal jurisdiction.

Compliance Office oversees that the Bank is effectively managing compliance of regulatory risk as prescribed by the Compliance Manual. The same unit is also responsible for the implementation of the Anti-Money Laundering Program.

<u>Credit Risk</u>

Credit risk pertains to risk of financial loss due to non-payment by borrowers, issuer or counterparties of their obligations, deterioration in credit quality and reduced recovery from a credit facility in the event of default. The Bank is exposed to credit risk as lender, holder of securities and as counterparty in trading activity.

The Bank follows the Single Borrower's Limit prescribed by the Bangko Sentral ng Pilipinas (BSP). Credit exposures are constantly monitored and a credit evaluation process is conducted to assess the credit-worthiness of each borrower. The result of the credit evaluation is used as basis in adjusting credit lines periodically. To efficiently manage credit exposures, collateral and other applicable agreements are executed with counterparties whenever possible.

The Bank monitors and reviews from time to time the credit practices and reporting, and if appropriate, approve credit policy changes and procedures to ensure that credit policies are appropriate and are being complied with.

Activities, Information and Communication, Electricity, Gas, Steam and Airconditioning Supply and Activities of Extra-Territorial Org. and Bodies.

In terms of credit risk monitoring, the Bank prepares report on credit quality as summarized below (In million Pesos):

	2016	**2015**
Neither past due nor impaired	3,642	5,888
Past Due but not impaired	121	65
Impaired	2,105	462
	5,868	6,415
Less: Specific allowance for credit losses	295	209
	5,573	6,206

The Bank further classifies its non-performing loans into secured and unsecured (In million Pesos):

	2016	**Per cent**	**2015**	**Per cent**
Secured	1,610	76	181	39
Unsecured	495	24	281	61
	2,105	100	462	100

Market Risk

The Bank's exposure to market risks originates primarily from its risk-taking activities on fixed income investments in securities and foreign exchange effects. Transaction limits are used to operationally manage market risks.

Market risk is the risk that changes in interest rates, foreign exchange rates, equity prices, commodity prices and other market indicators may affect the Bank's income or values of its financial assets. The Bank uses mark-to-market and factor sensitivity to manage risk on its securities portfolios.

Treasury market risks originate from its holdings of debt securities mainly as compliance to liquidity reserves for government deposits. Further, it classifies its debt securities exposures under trading and non-trading portfolios. The Bank has an outstanding exposure of P 50 million under the Held for Trading (HFT) portfolio as of December 31, 2016.

The Bank's government securities classified under Available for Sale Securities (AFSS) which have an average yield to maturity (YTM) of 3.27% registered an unrealized loss/marked to market loss of P36.088M for a P547M portfolio.

For Unquoted Debt Securities Classified as Loans (UDSCL) being used as alternative compliance to Agri-Agra law, the Bank's exposure amounted to P50 million with an average coupon rate 6.5 per cent.

Liquidity Risk

Liquidity risk pertains to potential losses to the Bank arising from either its inability to meet its obligations or to fund maturing liabilities as they fall due. Senior Management through the Assets and Liabilities Management Committee (ALMC) is responsible for the implementation of sound policies and procedures keeping in mind the strategic direction and risk appetite of the Bank.

Liquidity risk is the risk of loss to earnings or capital due to inability to meet funding requirements or payment of obligations as they fall due. Postbank liquidity policy is to maintain sufficient liquidity level not only to service deposit withdrawals and other contractual obligations but also to provide ample buffer to meet any unplanned changes in funding sources or changes in market conditions. Part of liquidity management strategy is to keep a sizeable amount of liquid assets like marketable government securities, and Deposit Balances with BSP such as Special Deposit accounts (SDA).

The Assets and Liabilities Management Committee (ALMC) and Treasury Group supervise the liquidity planning of the Bank both for the day-to-day funding requirements and for balance sheet management purposes. Daily cashflow projection and analysis of liquidity position are prepared with any excess funds temporarily park on interbank placements or deposit balances with BSP.

The liquidity risk management process at Postbank also includes the preparation of liquidity gap reports. Also called Maximum Cumulative Outflow (MCO) report, it reveals the mismatch on the tenor of the assets against liabilities with risk that the Bank may be forced to borrow at higher rate or sell its assets at a discount to generate the required liquidity. The analysis of the MCO report contains risk mitigating measures on how to close the negative gaps particularly on the shorter tenor buckets. The MCO report also takes into account behavioral pattern of deposit withdrawal specifically deposits retained beyond the contractual maturity.

Presented below is the Maximum Cumulative Outflow (MCO) report as of December 31, 2016 (In million Pesos).

	Up to 90 days	**91 days to 1 year**	**Over 1 year to 5 years**	**Over 5 years to 15 years**	**Total**
Assets					
Cash and cash equivalents*	98	0	0	0	98
Due from BSP & other banks*	4,582	0	0	0	4,582
Investment securities	48	0	50	548	646
Loans and receivables	486	1,083	1,159	2,886	5,614
Other assets*	118	24	41	475	658
	5,332	1,107	1,250	3,909	11,598
Liabilities					
Deposit liabilities*	9,244	476	4	0	9,724
Accrued interest expense*	5	10	0	0	15

	Up to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 15 years	Total
Other liabilities*	877	0	0	0	877
	10,126	486	4	0	10,616
Equity*				982	
Net Liquidity surplus (gap)	(4,794)	621	1,246	2,927	
Cumulative gap	(4,794)	(4,173)	(2,927)	0	

* Includes accounts in Foreign Currency Deposit Unit (FCDU)/Expanded Foreign Currency Deposit Unit (EFCDU).
1/ Includes Core deposits or those funds expected to remain with the Bank after deducting for volatile deposits and reserves that can be used for lending operations.

Interest Rate Risk

The Bank follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable levels. Risk is addressed on a transactional level by matching the benchmark rate or basis for repricing of a particular asset with that of the equivalent source of fund at the onset of the transaction. Further, sensitivity analysis is regularly performed to efficiently manage risk on earnings.

When measuring interest rate risk, we consider liabilities as funding the Bank's asset (inversely related to liquidity risk, where we looked at assets as sources of funds to pay off maturing liabilities). The balance sheet is pulled apart into time buckets, showing when the assets will and liabilities will reprice or change their interest rates. The re-pricing gap analysis is calculated by first slotting the interest rate sensitive assets and liabilities into tenor buckets according to next re-pricing date (or the time remaining to maturity if the account has a fixed term), and then obtaining the difference or gap per defined buckets. A gap is considered negative when the level of interest rate sensitive liabilities exceeds that of assets. Conversely, a positive gap indicates more interest rate sensitive assets than liabilities. In an increasing interest rate scenario, a negative re-pricing gap would translate into potential reduction in interest income.

The following table shows the re-pricing gap position of Postbank as of December 31, 2016 (In million Pesos):

	Up to 1 month	Over 1 month to 3 months	Over 3 months to 1 year	Over 1 year to 3 years	Over 3 years to 5years	Over 5 years to 15 years	Over 15 years	Total
FINANCIAL ASSETS								
Due from other banks	1,016	0	0	0	0	0	0	1,016
Total investments	48	0	0	50	0	548	0	646
Total loans and receivables	1,228	197	250	688	307	748	6	3,424
Sales contract receivables	0	0	1	5	28	0	0	34
Total Financial Assets	2,292	197	251	743	335	1,296	6	5,120

	Up to 1 month	Over 1 month to 3 months	Over 3 months to 1 year	Over 1 year to 3 years	Over 3 years to 5years	Over 5 years to 15 years	Over 15 years	Total
FINANCIAL LIABILITIES								
Deposit liabilities	4,303	4,793	626	0	2	0	0	9,724
Total Financial Liabilities	4,303	4,793	626	0	2	0	0	9,724
Repricing Gap	**(2,011)**	**(4,596)**	**(375)**	**743**	**333**	**1296**	**6**	**(4,604)**

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are broken down as follows:

	2016	2015
Cash on Hand	97,236,828	99,085,473
Checks and Other Cash Items	643,748	7,853,807
Petty Cash Fund	39,000	100,000
	97,919,576	**107,039,280**

7. DUE FROM BANGKO SENTRAL NG PILIPINAS

This account represents the following: a) demand deposits which the bank utilizes in its clearing operations, b) Special Deposit Account for liquidity requirement purposes, and c) Reserve Deposit Account for the Circular 10 compliance of the bank with the Bangko Sentral ng Pilipinas.

	2016	2015
Reserve Deposit Account	1,270,000,000	1,977,000,000
Demand Deposit Account	579,700,615	681,121,435
	1,849,700,615	**2,658,121,435**

8. DUE FROM OTHER BANKS

This account represents demand deposit account, short-term investments in special savings deposits and premium savings account deposited with the following banks:

	2016	2015
Maybank	645,980,535	517,992,437
Landbank of the Philippines(LBP) Peso Account	443,167,189	3,009,428
China Bank	248,996,386	503,800,256
United Coconut Planters Bank (UCPB) Peso Account	214,220,188	87,583,809
Security Bank	201,288,444	0

	2016	2015
Malayan Bank	201,086,875	0
Union Bank	200,952,800	0
East West Bank	199,940,017	0
Metro Bank and Trust Company	199,526,400	504,790
Asia United Bank	150,675,582	1,050,535
Philippine National Bank (PNB) Peso Account	11,574,094	15,985,822
Philippine Business Bank	11,280,068	1,471,639,217
Rizal Commercial Banking Corporation	2,956,806	6,616,716
Philippine Savings Bank	136,348	219,566
Banco de Oro Unibank, Inc.	61,379	62,256
Development Bank of the Philippines	27,949	29,091
UCPB US Dollar Account	0	2,504,942
PNB US Dollar Account	0	215,418
LBP US Dollar Account	0	100,648
	2,731,871,060	**2,611,314,931**

9. LOANS & RECEIVABLES

This account consists of:

	2016	2015 As restated
Loans to Private Corporation	2,602,327,102	2,948,734,019
Small & Medium Enterprises	933,113,887	998,800,045
Consumption Loans	850,629,878	900,097,949
Agrarian Reform &Other Agricultural Loans	413,021,660	388,089,625
Loans to Government	380,076,388	469,887,596
Contract to Sell	365,403,240	437,252,575
Microfinance Loans	134,437,435	80,965,343
Loans to Individuals for Housing Purposes	107,428,159	114,512,730
Loans to Individuals for Other Purposes	82,345,535	76,264,742
	5,868,783,284	**6,414,604,624**
Allowance for Losses	(333,047,323)	(300,435,937)
Net of Allowance	**5,535,735,961**	**6,114,168,687**

As to Status:

	2016	2015 As restated
Current Loans	3,763,119,508	5,953,000,393
Non-Performing Loans	2,105,663,776	461,604,231
	5,868,783,284	**6,414,604,624**

As to Security:

	2016	2015 As restated
Secured Loans	4,087,555,859	4,763,632,341
Unsecured Loans	1,781,227,425	1,650,972,283
	5,868,783,284	**6,414,604,624**

As to Type of Security:

	2016	2015
Real Estate Mortgage	3,369,694,665	2,805,383,235
Other Collaterals	717,861,194	1,958,249,106
	4,087,555,859	**4,763,632,341**

Consumption loans include financial assistance given to eligible employees of the PPC & PPSBI, for personal consumption such as educational, hospital or medical, appliance purchase and/or working capital for business/ livelihood purposes in the form of salary loans in a maximum amount of P150,000 and P250,000, respectively.

10. LOANS AND RECEIVABLES ARISING FROM RA/CA/PR/SLB

This pertains to loans arising from repurchase agreement with Bangko Sentral ng Pilipinas.

11. HELD FOR TRADING FINANCIAL ASSETS

This comprises securities purchased from Rizal Commercial Banking Corporation.

12. AVAILABLE FOR SALE FINANCIAL ASSETS

This account is composed of investments in government treasury bills and fixed treasury notes purchased from the following:

	2016	2015
Rizal Commercial Banking Corporation	300,182,352	0
Security Bank Corporation	106,444,289	0
East West Banking Corporation	93,940,978	0
China Bank	46,970,489	0
Hongkong and Shanghai Bank	0	22,437,127
	547,538,108	**22,437,127**

13. UNQUOTED DEBT SECURITIES CLASSIFIED AS LOANS

These are securities invested for compliance purposes:

	2016	2015
Philippine Commercial Capital, Inc.	50,085,797	50,163,524
SB Corporation Note (MSME)	0	10,102,928
Rizal Commercial Banking Corporation	0	0
	50,085,797	**60,266,452**

Investments in government securities are held by the Bureau of Treasury under the Registry of Scripless Securities (ROSS) System in compliance with BSP Memorandum Circular (series of 1997) dated October 6, 1997.

14. BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

This account consists of:

	Land	Building	Furniture Fixture & Equipment	Motor Vehicles	Computer and Peripherals	Lease, Right And Improvements	Totals
Cost 1-Jan-16	131,008,000	41,501,900	66,040,091	13,615,179	142,322,021	28,246,462	422,733,653
Additions	0	118,000	5,229,630	269,594	12,025,888	1,226,784	18,869,896
Disposals	0	0	(2,221,713)	(31,000)	(9,093,225)	(1,953,410)	(13,299,348)
Reclassifications	0	(118,000)	(2,387,744)	(7,600)	(7,189,665)	(465,561)	(10,168,570)
31-Dec-16	131,008,000	41,501,900	66,660,264	13,846,173	138,065,019	27,054,275	418,135,631
Accumulated Depreciation 1-Jan-16	0	8,462,304	56,150,973	11,876,052	127,939,957	20,036,738	224,466,024
Provisions	0	2,821,414	2,801,252	412,832	5,608,142	1,861,027	13,504,667
Disposals	0	0	(2,167,923)	(33,125)	(8,772,394)	(1,953,410)	(12,926,852)
Reclassifications	0	0	(1,467,111)	(7,410)	(2,753,003)	(312,950)	(4,540,474)
31-Dec-16	0	11,283,718	55,317,191	12,248,349	122,022,702	19,631,405	220,503,365
Carrying Amount 31-Dec-16	**131,008,000**	**30,218,182**	**11,343,073**	**1,597,824**	**16,042,317**	**7,422,870**	**197,632,266**
Carrying Amount 31-Dec-15 (restated)	131,008,000	33,039,596	9,889,118	1,739,127	12,907,145	8,184,551	196,767,537

PPSBI building was acquired thru Dacion En Pago from Philippine Postal Corporation on November 02, 2012 with booked value amounting to P37,567,000.

15. NON-CURRENT ASSETS HELD FOR SALE

These are real and other properties acquired that are available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and the sale must be highly probable.

	2016	2015
Head Office – Manila	46,617,105	46,515,679
Accumulated Depreciation	5,616,777	4,428,679
	41,000,328	42,087,000

	2016	2015
Allowance for Probable Losses	0	888,779
Net of allowance	**41,000,328**	**41,198,221**

16. INVESTMENT PROPERTY

Investment Property represent properties acquired by the Bank judicially in settlement of outstanding loans of delinquent borrowers. These are maintained by the Bank pending sale through public auction after a one-year redemption period as mandated by Bangko Sentral ng Pilipinas regulations.

	2016	2015
Head Office – Manila	243,893,515	90,136,572
Accumulated Depreciation	19,329,012	11,390,242
	224,564,503	78,746,330
Allowance for Probable Losses	4,375,493	6,981,400
Net of allowance	**220,189,010**	**71,764,930**

17. SALES CONTRACT RECEIVABLE

This account represents the amortized cost of assets acquired in settlement of loans through foreclosure or dacion in payment and subsequently sold on installment basis whereby the title to the said property is transferred to the buyers only upon full payment of the agreed selling price.

	2016	2015
Sales Contract Receivable	34,465,101	32,272,651
Less: Provision for Credit Losses	0	0
Net Amount	**34,465,101**	**32,272,651**

18. OTHER ASSETS

This account is composed of the following:

	2016	2015 As restated
Accrued interest income from financial assets	74,431,389	59,468,886
Miscellaneous assets	70,377,335	57,266,821
Accounts receivables	23,433,329	22,586,648
Prepaid expenses	16,233,422	15,766,058
Other intangible assets -net	2,244,048	2,360,773
Stationery and supplies on hand	4,215,901	4,266,132
Documentary stamps on checks	1,715,095	2,780,288
Returned checks and other cash items	924,270	805,688
Other investments	153,333	153,333
Sundry debits	92,586	642,303

	2016	2015 As restated
Shortages	0	481,850
	193,820,708	166,578,780
Other Assets – Allowance for Losses	(29,411,836)	(9,515,095)
	164,408,872	**157,063,685**

The Accounts Receivable account includes the amount of P4 million and P7.3 million misappropriated by the former Cashiers of Sorsogon and Tacloban Branches for which cases were already filed in court.

Payments for our ongoing LMS/GL and Deposit System projects amounting to P51.16 million and P8.26 million, respectively, were temporarily lodge to Miscellaneous Assets account.

19. DEPOSIT LIABILITIES

	2016	2015
Domestic:		
Demand deposits	373,644,104	454,918,662
Savings deposits	6,210,047,257	7,523,427,281
Time certificate of deposits	496,327,514	296,965,169
Foreign:		
Savings deposits	2,301,048	2,496,119
Time certificate of deposits	2,641,321,146	2,487,453,853
	9,723,641,069	**10,765,261,084**

Domestic deposit liabilities earns annual fixed interest rates ranging range from 0.25 to 3.05 per cent in 2016 and 2015. Foreign deposits range from 0.25 to 1.375 per cent and from 0.25 to 1.5125 per cent in 2016 and 2015, respectively.

20. BILLS PAYABLE

These are interbank term loans from other banks and non-bank financial institutions with quasi-banking authority, other than those payable on call/demand.

	2016	2015
Maybank	500,000,000	0
China Bank	150,000,000	0
Net Amount	**650,000,000**	**0**

21. ACCRUED EXPENSES

This account represents:

	2016	2015 As restated
Accrued interest expense in financial liabilities	14,992,853	18,278,041
Fringe benefits	13,641,796	10,456,346
Litigation/assets acquired	12,075,254	13,380,188
Other taxes and licenses	2,801,265	3,646,703
Rent	2,614,404	5,536,223
Security, clerical, messengerial and janitorial	2,019,078	3,311,511
Salaries and wages	1,245,352	14,091,642
Power, light and water	748,732	844,041
Postage, telephone, cables and telegrams	592,812	397,594
Repairs and maintenance	411,400	452,111
Fuel and lubricants	166,911	138,350
Fines, penalties and other charges	14,592	11,592
Management and other professional fees	2,092	803,017
Income tax payable	0	23,502,870
Others*	14,745,863	11,837,094
	66,072,404	**106,687,323**

*Others include accruals for internet connection and subscriptions, PDIC Insurance, offsite storage services, disaster recovery collocation site services, preventive maintenance services for data center's UPS, air conditioning units and ATM units, card embossing services, travelling expenses, rental of PCSO with PPC Baguio, photocopy charges, advertising expenses, membership fees and representation expenses.

22. OTHER LIABILITIES

This account comprises:

	2016	2015 As restated
Accounts payable – others	63,118,341	77,779,202
Withholding tax payable	4,412,558	4,784,669
SSS, PHIC, Employee Compensation and Pag-ibig Fund payable	1,039,313	887,762
Inter-office float items	482,192	2,734,414
Unclaimed balances	292,762	244,472
Miscellaneous liabilities	211,455	213,807
Sundry credits	55,960	11,063
Overages	10,828	17,175
	69,623,409	**86,672,564**

The Accounts Payable account represents overpayment on loans pending refund, loans payment pending posting, contributions payable to BIR, SSS, PHIC, Bancnet, delivered items of supplies and equipment not yet paid and others.

23. CAPITAL STOCK

The Bank is authorized to issue 10,000,000 shares at P100.00 par value. Total subscribed is 8,802,428 shares amounting to P880,242,883. Five million (5,000,000) shares were subscribed by Philippine Postal Corporation of which P440,000,000.00 was fully paid. Subscription receivable of P60,000,000.00 is still outstanding.

The Board of Directors of the Bank, through Board Resolution No. 2011-274, approved the issuance to the Republic of the Philippines of common shares of stock with par value equal to the cash balance of the Project Drive Fund amounting to P249,234,883 or equivalent to 2,492,348 shares. The National Government has consented to the treatment of the Fund as capital in the books of PPSBI per memorandum from the Executive Secretary of the Office of the President of the Philippines dated December 16, 2011. This Fund represents the outstanding balance from P500,000,000.00 previously released by the National Government to PPSBI for disbursement to the National Government's microfinance program for the transport sector.

The Project Drive Fund was subjected to special audit conducted by audit team created under Commission on Audit (COA) Office Order No. 2014-758 dated December 22, 2014 and COA Office Order No. 2015-258 dated April 23, 2015.

Additional issuance of common shares of stock for the National Government was made by PPSBI corresponding to the latest appraised value of parcel of land where Head Office is situated per Board Resolution No. 201-142 dated June 10, 2014. Total common shares of stock issued to the National Government as of December 31, 2016 is 3,802,428 shares or equivalent to P380,242,800.00.

24. UNREALIZED GAINS/LOSSES ON AFS FINANCIAL ASSETS

This account refers to the gains and losses from marking to market valuation of AFS securities which is booked on a daily basis.

25. RETAINED EARNINGS UNAPPROPRIATED

In consonance with PAS 8, the balance of this account as of December 31, 2015 were restated for prior period adjustments. The adjustments principally relate to reversal of accrued interest income, reversal of erroneous recordings, disallowances, reclassification of various accounts, recognition of expenses and the write-off of non-performing loans.

Retained earnings of the Bank as December 31, 2015 have been restated as follows:

Particulars	Debit	Credit	Balance
Retained earnings, beg. FY 2016 before restatement			143,279,499
Adjustments:			
Prior period – refund of directors allowance	0	110,000	
	0	110,000	110,000
Restated retained earnings, beg			143,389,499
Net Income before restatement			134,706,052
Adjustments:			
Interest income	4,109,053	25,035	
Other income		71,533	
Additional income tax	13,422,438		
Depreciation on BPFFE	1,515,462	15,371	
Compensation and fringe benefits	11,087,158		
Supplies expense		45,750	
Write off of non performing loans	407,185		
Collection of payment on capital gain tax		247,211	
Reversal of capitalized interest charged on income	38,439,564		
	68,980,860	404,900	(68,575,960)
Restated net income for FY 2015			66,130,092
Restated retained earnings, end			209,519,591

26. INCOME AND OTHER TAXES

Under Philippine tax laws, the Bank is subject to Percentage and Other Taxes as well as income taxes. Percentage and other taxes paid consist principally of gross receipt tax (GRT) and documentary stamp tax (DST).

Income taxes include the corporate income tax and final taxes paid at the rate of 20 per cent, which is a final withholding tax on gross interest income from government securities.

Interest allowed as a deductible expense is reduced to an amount equivalent to 33 per cent of interest income subject to final tax.

	2016	2015
Documentary Stamp Taxes	33,250,701	30,661,587
Percentage Taxes (2551M)	25,427,259	30,676,934
Income Taxes on Compensation (1601C)	24,171,931	21,559,837
Final Income Taxes (1602)	21,825,586	19,683,434
VAT & Other Percentage Taxes (1600)	5,156,209	6,359,668
Annual/Quarterly Income Taxes (1702)	4,926,109	32,196,992
Creditable Income Taxes (1601E)	4,046,943	4,331,479
Annual Registration	12,500	12,500
	118,817,238	**145,482,431**

27. MISCELLANEOUS INCOME

This account represents additional interest and penalty charges on loans and other fees collected by the bank. Penalties on past due loans amounted to P42.428 million and others P9.828 million.

28. OPERATING EXPENSES

	2016	2015 As restated
Compensation and fringe benefits	214,010,367	200,710,507
Provision for probable losses	57,886,486	58,178,718
Rent	33,313,395	29,963,445
Taxes and licenses	32,005,318	35,156,546
Information technology	28,984,278	19,403,142
Insurance	28,429,005	22,303,200
Depreciation and amortization	27,519,473	26,188,991
Security, clerical, messengerial and janitorial	19,728,490	20,859,769
Documentary stamps used	14,495,390	13,058,875
Management and other professional fees	13,013,125	9,595,151
Representation and entertainment	12,459,711	13,113,999
Power, light and water	10,971,438	11,283,151
Traveling expense	7,048,730	6,582,679
Stationeries and supplies used	5,785,896	6,364,098
Repairs and maintenance	5,724,742	5,881,212
Postage, telephone, cable and telegram	4,921,759	4,806,426
Litigation expenses	4,108,871	3,246,582
Training and seminars	3,820,793	2,754,063
Fees and commission	2,770,160	2,788,876
Supervision fees	2,273,784	2,028,987
Fuel and lubricants	1,756,946	1,927,378
Membership fees and dues	1,293,424	834,273
Advertising and publicity	750,260	1,430,758
Fines, penalties and other charges	492,900	316,509
Impairment loss	343,806	85,400
Periodicals and magazines	116,227	113,490
Donation and charitable contributions	64,089	213,015
Bad debt expenses	0	595,984
Miscellaneous expenses	742,020	1,064,931
	534,830,883	**500,850,155**

29. BASIC QUANTITATIVE INDICATORS OF FINANCIAL PERFORMANCE

	2016	2015
	(In percentage)	
Return on Average Equity	-1.13	13.11
Return on Average Assets	-0.10	1.23

Net Interest Margin	3.70	4.96
Risk Based Capital Adequacy Ratio	5.31	11.04

30. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the bank has loans, deposits and other transactions with its related parties and with some directors, officers and related interest (DOSRI).

The loan granted by the bank to its mother company, Philippine Postal Corporation (PPC) in December 2006 and July 31, 2008 has an outstanding balance of 45.38 million as of December 31, 2016. The loan is secured by REM and a deposit holdout of peso and dollar deposits with the bank. Payments of monthly amortizations were effected thru offsetting of the building rentals and direct payments.

The total DOSRI loan as of year ended 2016 is P49.354 million which were fully secured and on a current status which represents .84 per cent of the total loan portfolio.

31. COMMITMENTS AND CONTINGENT LIABILITIES

The bank is contingently liable for lawsuits or claims filed by third parties, which are either pending decision by the courts or under negotiations, the outcomes of which are not determinable at balance sheet date.

32. SUBSEQUENT EVENTS

Investment in notes by the Quedan and Rural Credit Guarantee Corporation (Quedancor) for the bank's Agri-agra compliance is now under negotiation for the replacement by Quedancor Restructured Notes. This was lodged under the Unquoted Debt Securities Classified as Loans account and was fully provided with allowance for losses and accruals for the litigation expenses.

32. AUTHORITY TO ISSUE FINANCIAL STATEMENTS

As per Stockholders' Resolution No. 2017-72 entitled "CONFIRMATION OF THE 2016 ANNUAL REPORT of the PPSBI", which contains its 2016 Financial Statements, was presented to and duly confirmed and noted by the Board of Directors during the 6th Regular Meeting of the Board of Directors of Philippine Postal Savings Bank, Inc. held on April 25, 2017.

33. EVENTS AFTER THE REPORTING DATE

On March 14, 2017, the Board of Directors accepted and approved the resignation of Mr. Cesar N. Sarino as President/CEO of the Philippine Postal Savings Bank, Inc. Consequently the Board of Directors appointed Mr. Renato G. Eje, First Vice President of Land Bank of the Philippines as Officer-in-Charge effective immediately.