



Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Ave., Quezon City
CORPORATE GOVERNMENT SECTOR
CLUSTER 1 – BANKING AND CREDIT

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of **Philippine Postal Savings Bank, Inc.**, a subsidiary of the Philippine Postal Corporation, which comprise the statement of financial position as at December 31, 2012, and the statement of comprehensive income, statement of changes in equity and statement 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 audit in accordance with International 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.

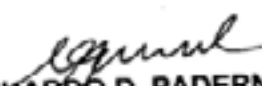
Bases for Qualified Opinion

As discussed in item nos. 1 and 2 of Part II-A of the audit report, the Loans and receivables account with a net balance of P2.694 billion as at December 31, 2012 was carried in the books at its diminishing cost instead of the amortized cost using the effective interest rate; and impairment loss amounting to P92.588 million for secured/unsecured past-due loans which were of doubtful collectibility was not recognized resulting in the overstatement of the account and the income for the period, both contrary to PAS 39. More so, the non-recognition of impairment loss is also contrary to BSP Circular No. 313.

Qualified Opinion

In our opinion, except for the effects of the matters discussed in the Bases 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, 2012, and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

COMMISSION ON AUDIT


EDUARDO D. PADERNAL
Supervising Auditor

June 3, 2013

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENT OF FINANCIAL POSITION
December 31, 2012
(in Philippine Peso)

	Note	2012	2011 As restated
RESOURCES			
Cash and cash equivalents	6	135,103,048	101,522,576
Due from Bangko Sentral ng Pilipinas	7	584,190,478	809,954,463
Due from other banks	8	152,915,216	90,339,237
Loans and receivables - net	9	2,694,220,112	2,018,386,997
Loans and receivables arising from RA/CA/PR/SLB	10		910,000,000
Available for sale financial assets	11	434,391,494	371,292,653
Held to maturity financial assets	12	1,296,579,749	695,232,615
Unquoted debt securities classified as loans	13	477,651,935	477,187,186
Bank premises, furniture, fixtures and equipment - net	14	88,284,267	67,669,632
Real and other properties acquired - net	15	95,595,335	104,889,292
Sales contract receivable	16	56,128,839	65,876,931
Other resources	17	208,278,887	254,990,569
TOTAL RESOURCES		6,223,339,360	5,967,342,151
LIABILITIES AND EQUITY			
Deposit liabilities	18	4,891,357,383	4,850,148,406
Savings		240,245,759	196,216,525
Time		270,533,830	192,831,141
Demand		11,823,067	18,506,545
Manager's/Cashier's checks		2,924,644	3,257,826
Unearned income and other deferred credits		34,286,557	28,094,014
Accrued taxes and other expenses	19	51,614,693	35,564,580
Other liabilities	20		
TOTAL LIABILITIES		5,502,785,933	5,324,618,837
EQUITY	23	720,553,427	642,723,314
TOTAL LIABILITIES AND EQUITY		6,223,339,360	5,967,342,151

The Notes on pages 7 to 25 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENT OF COMPREHENSIVE INCOME
For the year ended December 31, 2012
(In Philippine Peso)

		2011	
	Note	2012	As restated
INTEREST INCOME			
Interest/discount earned on loans & discounts		303,164,042	293,262,398
Interest on investments		108,438,980	94,833,084
Interest income - loans and receivable arising from RA/CA/PR/SLB		13,551,839	12,274,322
Interest on due from Bangko Sentral ng Pilipinas		31,015,645	22,038,712
Interest on deposits with banks		623,039	769,531
Interest income on sales contract receivable		388,281	49,891
Others		200	
		457,182,026	423,227,938
INTEREST EXPENSE			
Interest on deposit liabilities		123,677,835	100,850,750
Provision for losses on accrued interest income		54,836	111,185
		123,732,471	100,961,935
		333,449,555	322,266,003
NET INTEREST INCOME			
OTHER INCOME			
Fees and commission income		46,536,358	56,262,942
Gain/loss from sale/derecognition of non-financial assets		7,677,349	(2,261,177)
Gain on financial assets and liabilities held for trading		816	36,148
Gain from sale/redemption/derecognition of non-trading financial assets & liabilities			503,478
Foreign exchange (loss)/gain		2,629	(2,366)
Recovery on charged-off assets		60,498	67,670
Miscellaneous income	25	15,887,584	19,258,826
		69,965,234	73,865,521
	26	373,048,225	390,087,263
OPERATING EXPENSES			
		30,368,564	6,044,261
NET INCOME			
		7,463,549	5,646,338
OTHER COMPREHENSIVE INCOME			
		37,830,113	11,690,599
TOTAL COMPREHENSIVE INCOME			

The Notes on pages 7 to 25 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2012
(In Philippine Peso)

	Capital Stock (Note 23)	Other Comprehensive Income	Retained Earnings Unappropriated (Note 22)	Total Equity
Balance January 1, 2011	300,000,000	28,462,228	98,322,263	426,784,489
Issuance of Capital Stock	249,234,883			249,234,883
Unrealized Gains on Available for Sale Securities		5,646,338		5,646,338
Prior period adjustments			(44,986,657)	(44,986,657)
	549,234,883	34,108,574	53,335,596	636,679,053
Net income, 2011 before restatement			5,335,547	5,335,547
Correction of errors			708,714	708,714
Net income, 2011 as restated			6,044,261	6,044,261
Balance, December 31, 2011 as restated	549,234,883	34,108,574	59,379,857	642,723,314
Issuance of Capital Stock	40,000,000			40,000,000
Unrealized gain on available for sale securities		7,483,549		7,483,549
Net income, 2012			30,366,564	30,366,564
Balance, December 31, 2012	589,234,883	41,592,123	89,746,421	720,573,427

The Notes on pages 7 to 25 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
STATEMENT OF CASH FLOWS
For the year ended December 31, 2012
(In Philippine Peso)

	Note	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Proceeds from/placements of investments- RAs		910,000,000	(484,000,000)
Interest income, fees and commission received		507,556,581	506,970,458
Proceeds/withdrawal to BSP for regulatory or monetary control purposes		225,763,985	(357,319,219)
Deposit from customers		182,940,900	683,270,420
Cleared/returned checks and other cash items		38,196,511	(34,873,347)
Payments/proceeds of unidentified cleared checks		25,974,949	(25,516,759)
Issued checks to suppliers not yet presented for payment		14,270,865	18,506,545
Recoveries on loans previously written off		60,498	67,670
Income from assets held for trading		816	36,148
Release/collection of loans and receivables		(649,070,469)	14,125,875
Fund advances/collection to customers		(5,239,601)	2,266,710
Cash payments to suppliers		(196,458,099)	(198,888,173)
Cash payments to employees		(143,746,170)	(145,116,093)
Interest and finance charges		(120,980,556)	(102,077,935)
Transfer of funds from regional branches		(61,791,414)	(5,904,375)
Payment from purchase of financial assets		(55,835,293)	(25,588,948)
Payment of taxes and licenses		(27,411,083)	(88,308,585)
Payment of litigation/asset acquired expenses		(7,347,401)	(9,880,471)
Advances to branches		(1,962,080)	(219,740,854)
Receipts of refundable deposits		-	28,783,587
Profit from sale of investments		-	503,478
Net cash generated by/(used) in operating activities		613,122,939	(442,683,868)
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of ROPA/release of sales contract receivable		19,042,049	(21,975,201)
Profit/(loss) from asset sold		7,677,349	(2,261,177)
Rental income on safety deposit boxes		22,315	23,928
Purchase/sale of non dealing securities		(601,347,134)	127,195,727
Acquisition of property and equipment		(43,929,204)	(13,295,734)
Acquisition/payment of intangibles (computerization expenses)		(545,722)	(1,672,165)
Purchase/sale of unquoted debt securities classified as loans		(484,749)	107,965,684
Net cash generated by/(used in) investing activities		(619,545,096)	195,981,062
CASH FLOWS FROM FINANCING ACTIVITIES			
Issuance of common shares		40,000,000	249,234,883
Net cash generated by financing activities		40,000,000	249,234,883
Net effect of exchange rate changes on cash and cash equivalents		2,629	(2,366)
NET INCREASE IN CASH AND CASH EQUIVALENTS		33,580,472	2,529,711
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		101,522,576	98,992,865
CASH AND CASH EQUIVALENTS AT END OF YEAR	6	135,103,048	101,522,576

The Notes on pages 7 to 25 form part of these financial statements.

PHILIPPINE POSTAL SAVINGS BANK, INC.
(A Subsidiary of the Philippine Postal Corporation)
NOTES TO FINANCIAL STATEMENTS
(All amounts in Philippine Peso unless otherwise stated)

1. GENERAL INFORMATION

The 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 Republic Act No. 7354, otherwise known as Postal Services 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 (BSP) Monetary Board Resolution No. 267 dated March 18, 1994. The Bank was incorporated on June 22, 1994 and started its operation 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 located at Liwasang Bonifacio, Intramuros, Manila.

In these financial statements, the Philippine Postal Savings Bank, Inc. is also referred to as the "PPSBI" or the "Bank."

As at December 31, 2012, the Bank had 350 employees and has 25 branches, 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 City Branch

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

Visayas Area:

1. Tacloban, Leyte Branch
2. Tagbilaran, Bohol Branch

3. Iloilo City Branch
4. Himamaylan, Negros Occidental Branch
5. Cebu City Branch
6. Bacolod Branch

Mindanao Area:

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Financial Statements Preparation

The Bank's financial statements have been prepared in accordance with accounting principles generally accepted in the Philippines as set forth in the Philippine Financial Reporting Standards/Philippine Accounting Standards (PFRS/PAS). These financial statements are prepared on the historical cost basis modified by the fair value measurement of financial assets on Available for Sale Securities.

The financial statements of the Bank reflect the combined financial transactions of the Head Office and its 24 branches nationwide as well as the accounts maintained in the Regular Banking Unit and Foreign Currency Deposit Unit.

The preparation of financial statements 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.

2.2 Foreign currency translation

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

2.3 Cash and other cash items

For purposes of presentation in the statement of cash flows, cash and other cash items consists of cash and other cash items on hand.

2.4 Due from other banks

This account refers to the balances of funds on deposit 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

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, these assets/liabilities are measured 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 assets are derecognized or impaired at which time the cumulative gain or loss previously recognized in equity shall 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)

AFS 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.

2.6 Unquoted Debt Securities Classified as Loans

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

2.7 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 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 Government, Agri-agra, Development Incentive, Small and Medium Enterprise, Microfinance, Contract to sell and others) are carried in the books at its amortized cost or the amount at which the financial asset or financial liability 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.

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

Inter-bank loans represent overnight lending with the BSP with interest rates at an average of 3.85 per cent (highest 4.25 percent lowest 3.5 per cent). These are recorded at cost which represents fair value.

2.8 Sales Contract Receivable (SCR)

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 receivable due from borrowers. 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.

2.9 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 Real and Other Properties Acquired, Bank Premises, Furniture, Fixtures and Equipment 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.

2.10 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 over the estimated useful lives of the related assets as shown on the next page:

Building	10-20 years
Furniture and fixtures	5-10 years
Equipment	2-5 years
Leasehold improvements	5 years (maximum)

PPSBI building was acquired thru Dacion En Pago with booked value amounting to P37,567,000.

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 the leasehold improvements is amortized over the term of the lease or the estimated useful life of the improvements not exceeding five 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.

2.11 Real and Other Properties Acquired (ROPA)

These are real and other properties, other than those used for banking purposes or held for investments, acquired by the Bank in settlement of loans through foreclosure or dation in payment and/or for other reasons, whose carrying amount will be recovered principally through a sale.

ROPA are booked initially at the carrying amount of the loan plus booked accrued interest less allowance for credit losses plus transaction costs incurred upon acquisition. If the carrying amount of the ROPA exceeds P1 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP.

ROPA are sub-classified into land, building and other assets. Buildings and other assets are depreciated over 10 and 3 years, respectively, per BSP Circular 494.

2.12 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 three branches (in the cities of Cagayan de Oro, Baguio and Dagupan) from PPC, 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 to 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.

2.13 Intangible Assets

Intangible assets represent cost 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. Cost associated with the developing or maintaining computer software programs are recognized as an expense as incurred. Costs 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.

2.14 Deferred Tax Asset

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

2.15 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 portfolios 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 judgments 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 determines that AFS investments are impaired when there has been a significant or prolonged decline in fair value (market value) below its cost. This determination of what is significant or prolonged 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 amortized cost.

3.4 Impairment of ROPA/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 AND LIABILITIES

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

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

4.2 Short term investments – carrying amount approximates fair values.

4.3 Others – quoted market prices are not readily available for these assets. They are reported at cost.

4.4 Cash and cash equivalents – carrying amounts approximates 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. The committee has devised a mechanism to ensure an ongoing review of systems, policies and procedures to adapt to changes.

The RMC provides oversight on the Bank's policies and procedures in relation to the management and control of financial risks of the Bank and ensure that the system of limits to discretionary authority that the Board delegates to management is observed and that immediate corrective action are taken whenever there is breach of established limits.

Credit Risk

The risks from a borrower or a counterparty to a financial instruments failing to meet contractual obligations to the Bank or to perform as agreed.

The Bank follows the Single Borrower's Limit prescribed by the 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.

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.

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 is responsible for the implementation of sound policies and procedures keeping in mind the strategic direction and risk appetite of the Bank.

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.

6. CASH AND CASH EQUIVALENTS

For purposes of presentation in the statement of cash flows, cash and cash equivalents includes the following:

	2012	2011
Cash on hand	134,373,615	101,006,583
Checks and other cash items	590,433	376,993
Petty cash fund	139,000	139,000
	135,103,048	101,522,576

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 Bank's compliance with BSP Circular 10.

	2012	2011
Reserved deposits	257,000,000	607,000,000
Demand deposits	327,190,478	202,954,463
	584,190,478	809,954,463

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:

	2012	2011 As restated
PNB US \$ Account	84,461,807	2,742,156
UCPB US \$ Account	31,508,836	32,856,995
UCPB Peso Account	16,710,426	31,080,444
Allied Banking Corp.	5,328,043	2,173,441

LBP Peso Account	4,874,095	7,002,201
RCBC	3,127,641	2,468,649
Bank of Commerce	2,838,772	1,329,040
PNB Peso Account	1,728,266	7,889,350
China Bank	1,476,262	1,919,716
Philippine Savings Bank	452,521	460,676
Metro Bank and Trust Co.	265,137	264,302
LBP US \$ Account	78,427	83,670
EPCI/BDO	64,983	67,566
Santander	-	1,031
	152,915,216	90,339,237

9. LOANS AND RECEIVABLES

This account consists of:

	2012	2011 As restated
Consumption loans	915,721,102	998,384,199
Loans to government	347,042,702	300,131,712
Loans to private corporation	706,310,871	273,732,352
Small and medium enterprises	319,578,177	237,870,820
Loans to individual – housing purposes	136,702,073	129,181,771
Agrarian reform and other agricultural	174,044,372	123,379,621
Development incentive loans – PD 717	189,785,838	122,712,088
Contract to Sell	68,785,366	-
Loans to individual - other purposes	64,341,588	42,977,822
Microfinance loans	623,817	707,529
	2,922,935,906	2,229,077,914
Allowance for probable losses	228,715,794	210,690,917
	2,694,220,112	2,018,386,997

As to status:	2012	2011
Current loans	2,480,688,976	1,940,445,210
Non-performing loans	391,675,192	236,193,013
Restructured loans – performing	12,979,156	15,629,708
Restructured loans – non performing	37,592,582	36,809,983
	2,922,935,906	2,229,077,914

Consumption loans include financial assistance given to eligible employees of the PPC and the Bank, 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 P100,000.

10. LOANS AND RECEIVABLES ARISING FROM REPURCHASE AGREEMENTS/CERTIFICATES OF ASSIGNMENT/PARTICIPATION WITH RECOURSE/SECURITIES LENDING AND BORROWING (RA/CA/PR/SLB)

This account represents overnight lending with BSP previously lodged under the Interbank Loans Receivable account but was later reclassified to Loans Receivable arising from RA/CA/PR/SLB Transaction per BSP recommendation amounting to P910,000,000 in CY 2011

11. AVAILABLE FOR SALE FINANCIAL ASSETS

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

	2012	2011
Philippine National Bank	112,926,830	-
Security Bank Corporation	110,133,023	112,111,480
First Metro Investment Corporation	106,596,969	51,912,246
United Coconut Planters Bank	57,035,214	57,081,107
Hongkong and Shanghai Bank	26,912,273	27,799,153
Multinational Investment Bancorporation	20,787,185	21,930,332
Land Bank of the Philippines	-	100,458,335
	434,391,494	371,292,653

12. HELD TO MATURITY FINANCIAL ASSETS

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

	2012	2011
Rizal Commercial Banking Corporation	409,248,451	79,117,722
Philippine National Bank	307,979,560	-
Security Bank Corporation	189,175,546	388,181,819
First Metro Investment Corp.	150,000,000	-
Union Bank of the Philippines	115,189,715	-
Multinational Investment Bancorporation	74,986,477	74,536,521
Philippine Veterans Bank	50,000,000	153,396,553
	1,296,579,749	695,232,615

13. UNQUOTED DEBT SECURITIES CLASSIFIED AS LOANS

These are securities invested for compliance purposes:

	2012	2011
GE Money Bank, Inc.	154,646,621	-
Philippine Commercial Capital, Inc.	150,231,471	-
Multinational Investment Bancorporation	100,000,000	-
Quedancor (Agri-Agra)	30,000,000	30,000,000
Small Business Guarantee and Fin. Corp.	20,000,000	-
Rizal Commercial Banking Corporation	16,979,372	-
LBP Trust Banking Group	5,794,471	-
NFA Bonds (Agri-Agra)	-	250,276,696
Home Guaranty Corporation (Agri-Agra)	-	148,673,032
SB Corporation Note (MSME)	-	20,000,000
Home Development Mutual Fund (Agri-Agra)	-	17,107,025
Liga ng mga Barangay	-	11,130,233
	477,651,935	477,187,186

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 & EQUIPMENT

This account consists of:

	Building	Furniture, Fixtures & Equipment	Motor Vehicles	Computer and Peripherals	Leasehold Rights and Improvements	Totals
Cost						
January 1, 2012	-	64,402,450	12,685,806	141,086,334	20,964,236	239,118,826
Additions	37,567,000	1,548,414	1,507,950	4,742,088	364,685	45,730,147
Disposals	-	(1,092,277)	-	(2,717,083)	(3,349,109)	(7,158,469)
Reclassifications	-	(399,810)	-	(1,042,007)	(664,971)	(2,096,788)
December 31, 2012	37,567,000	64,458,777	14,193,756	142,046,342	17,324,841	275,590,716
Accumulated Depreciation						
January 1, 2011	-	52,887,203	5,767,032	106,274,376	5,520,580	171,449,193
Provisions	352,191	3,792,958	2,227,421	11,921,431	1,626,072	19,920,073
Disposals	-	(706,306)	-	(2,452,094)	-	(3,158,400)
Reclassifications	-	(505,341)	(1,189)	(394,687)	-	(901,417)
December 31, 2012	352,191	55,468,514	8,993,264	115,348,828	7,146,652	187,309,449
Carrying Amount						
December 31, 2012	37,214,809	8,990,263	5,200,492	26,700,514	10,178,189	88,284,267
Carrying Amount						
December 31, 2011	-	11,515,248	5,918,774	34,791,956	15,443,658	67,669,632

As there are no considerable indications of impairment in the Bank's furniture, fixtures and equipment account, no allowance for impairment has been provided in the books.

15. REAL AND OTHER PROPERTIES ACQUIRED

ROPA 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 dictated by the BSP regulations

Breakdown of the ROPA accounts by location are as follows:

Branch	2012	2011
Head Office – Manila	85,161,107	93,320,336
Dagupan	6,971,582	7,426,832
Iloilo	3,164,990	3,801,125
Tacloban	2,770,000	2,770,000
San Fernando City, La Union	2,733,584	1,365,316
Cebu	1,200,000	3,449,740
San Pablo	1,100,000	-
Legazpi	900,000	-
Tuguegarao	781,762	-
Himamaylan	58,549	-
Manolo Fortich	-	2,739,236
	104,841,574	114,872,585
Accumulated depreciation	4,755,523	4,811,652
	100,086,051	110,060,933
Allowance for probable losses	4,490,716	5,171,641
	95,595,335	104,889,292

16. SALES CONTRACT RECEIVABLE

This account represents the amortized cost of assets acquired in settlement of loans through foreclosure or dation 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.

This account consists of:

	2012	2011
Vermillion Print and Pack	29,200,000	29,200,000
Generalship Inc. Management and Marketing		
Consultancy	10,200,000	12,920,000
Jackivi Trading Center (Jose C. Tanyao)	7,967,678	10,967,678
Gemma E. Hermoso (Sps. Tranquilino Mayol)	1,808,000	-

Feorilla B. Perez	1,308,085	-
Danilo R. Equipado (Juanito Magno)	1,161,364	-
Cherry Lou de Ala (Mungcal)	1,062,500	1,212,500
Henry P. Galope (Sps. Palima)	986,663	1,280,000
Sherry Magat Alonzao (Mungcal)	956,250	1,091,250
Rodrigo M. Burgos	577,215	-
Evelyn B. Servando (Elfred B. Servando)	330,932	-
Virginia C. Alcodia (Rosaly Sy)	270,000	342,000
Teodorico A. Residilla, Jr. (Hermilda Palmones)	151,666	-
Eduardo Vasquez	148,486	326,670
Marinette P. Perez (RCI Construction)	-	3,136,000
Christopher A. Corpus (Alberto Philip Corpus)	-	1,580,000
Jan Alfred F. Samson	-	1,293,600
Donato Marcos (Sps. Nicanor and Sisa Reyes)	-	1,250,000
Manuel Palanca (Jornalyn Matshusita)	-	593,900
Avelina Fenix (Marilyn Lazaro)	-	350,000
Engr. Ricardo C. Leynes (Marilou Tarona)	-	333,333
	56,128,839	65,876,931

17. OTHER RESOURCES

This account is composed of the following:

	2012	2011
Prepaid expenses	72,874,631	74,771,285
Accrued interest receivable	61,935,143	51,149,766
Other intangible assets	33,930,254	40,584,532
Miscellaneous assets	39,538,859	88,484,986
	208,278,887	254,990,569

The Prepaid expenses account includes the 42 months advance rental to the PPC equivalent to P67.488 million, which was approved by the Bank's Board of Directors per Board Resolution No. 2011-201 dated August 17, 2011.

18. DEPOSIT LIABILITIES

As at December 31, 2012, the Bank has P5.402 billion deposits, of which 70.31 per cent came from the government sector. Of the total deposit liabilities, P113.76 million represents foreign currency deposits with interest rates range from 0.50 per cent to 1.25 per cent. Peso deposits interest rates range from 0.50 per cent to 4.625 per cent.

19. ACCRUED EXPENSES

This account is composed of the following:

	2012	2011 As restated
Accrued expenses	22,398,741	17,387,872
Accrued interest expense on financial liabilities	10,398,529	7,701,250
Other taxes and licenses	1,489,287	3,004,892
	34,286,557	28,094,014

These accrued expenses represent accrued compensation and fringe benefits, rent, management and other professional fees, utilities, repairs and maintenance, security, messengerial and janitorial services, fuel and lubricants and others.

20. OTHER LIABILITIES

This account comprises:

	2012	2011
Accounts payable - Others	43,785,321	25,423,774
Inter-office float items	3,504,054	5,466,134
Withholding tax payable	3,347,001	3,735,238
SSS, PHIC, ECC and Pag-IBIG Fund payable	595,111	632,504
Deposit for keys on safety deposit boxes	207,260	168,553
Overages	5,841	4,036
Sundry credits	(78,181)	(75,494)
Miscellaneous liabilities	248,286	209,835
	51,614,693	35,564,580

The Accounts Payable - Others comprises of:

20.1 Special Fund in the amount of P500 million released by the Department of Budget and Management, through the Bureau of Treasury to the Bank for disbursement to the National Government's microfinance program for the transport sector.

Net of releases and subsequent collections, the fund has an outstanding balance of P256.579 million, of which P249.234 million was treated as capital in the books of the Bank per Board Resolution No. 2011-274 and also consented by the National Government per memorandum from the Executive Secretary dated December 16, 2011.

20.2 Overpayment on loans pending refund, payment of loans pending liquidation/posting, contributions payable to Bureau of Internal Revenue, Social Security System (SSS), Philippine Health Insurance Corporation (PHIC), Bancnet and others.

21. PROVISION FOR FINAL TAX

This account represents 20 per cent tax on gross income realized from government securities held during the period.

In compliance with generally accepted accounting principles in the Philippines on accounting for income taxes, the system of recording at gross all amounts/income from government securities was adopted by the Board effective January 1997. Prior to this, income from government securities was recorded at net of the 20 per cent final tax.

For financial statements presentation, the interest income derived from AFS securities account was presented net of 20 per cent final tax.

22. RETAINED EARNINGS

In consonance with PAS 8, the balance of this account was restated as follows:

	2012	2011 As restated
Retained earnings, beginning	59,379,857	98,322,253
Prior period adjustment	-	(44,986,657)
Retained earnings, beginning	59,379,857	53,335,596
Net income before restatement	30,366,564	5,335,547
Adjustment to net income	-	708,714
Net income	30,366,564	6,044,261
Retained earnings, end	89,746,421	59,379,857

22.1 PRIOR PERIOD ADJUSTMENT

Directors disallowance	2,542,908
Reconciling items on Due other banks	(784,565)
Reversal of booked retainer fees for CY 2008	155,000
Specific allowance (a)	(46,900,000)
	(44,986,657)

22.1a Specific allowance pertains to the partial booking by the Bank of P46.9 million allowances for probable losses. BSP Circular No. 763, Series of 2012, directed banks to charge on a one-time basis against retained earnings the outstanding unbooked valuation reserves in order to avail of the regulatory relief.

23. CAPITAL STOCK

The Bank is authorized to issue 10,000,000 shares at P100 par value. Total subscribed is 7,492,348 shares amounting to P749,234,883.

Five million (5,000,000) shares were subscribed by PPC of which 3,400,000 shares or P340,000,000 was fully paid. The 400,000 shares amounting to P40,000,000 was paid on December 13, 2012 by PPC as partial payment on the remaining balance of P200,000,000 equity share with the Bank.

Per Board Resolution No. 2011-274, the Board of Directors of the Bank 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 D.R.I.V.E. Fund amounting to P249,234,883 or equal to 2,492,348 shares. The National Government has consented to the treatment of the Fund as capital in the books of the Bank per memorandum from the Executive Secretary dated December 16, 2011. This Fund represents the outstanding balance from P500,000,000 previously released by the National Government to the Bank for disbursement to the National Government's microfinance program for the transport sector.

24. 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 and documentary stamp tax.

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 by an amount equivalent to 33 per cent of interest income subjected to final tax.

In compliance with the requirements set forth by Revenue Regulation 15-2010, hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year:

	2012	2011
Final income taxes	22,111,920	19,266,978
Documentary stamp taxes	19,419,111	14,135,762
Percentage taxes	16,274,095	17,597,196
Income taxes on compensation	14,788,890	14,306,547
VAT & other percentage taxes	4,664,670	4,295,877
Creditable income taxes	4,043,795	3,870,800
Annual/quarterly income taxes	661,636	317,990
Annual registration	12,500	12,500
	81,976,617	73,803,652

25. 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 P8,404 million and others P7,261 million.

26. OPERATING EXPENSES

Breakdown of this account is as follows:

	2012	2011 As restated
Compensation and fringe benefits	143,320,540	145,517,103
Rent	45,509,475	51,738,427
Depreciation and amortization	30,514,569	35,333,116
Taxes and licenses	19,882,271	20,506,104
Provision for probable losses	20,118,370	19,507,116
Security, clerical, messengerial and janitorial	15,652,449	18,501,783
Information technology	13,661,539	15,345,786
Insurance	14,304,033	12,548,545
Representation and entertainment	10,829,011	11,961,165
Power, light and water	10,610,823	10,789,881
Litigation expense	7,347,401	9,880,470
Postage, telephone, cable and telegram	6,746,254	7,561,104
Stationeries and supplies used	5,980,445	5,708,898
Traveling expenses	3,348,265	5,237,054
Documentary stamps used	8,155,038	4,990,434
Repairs and maintenance	4,439,155	3,890,731
Fuel and lubricants	2,720,566	2,740,474
Management and other professional fees	4,254,308	2,139,919
Supervision fees	1,530,490	1,524,614
Fees and commission	1,920,855	1,474,246
Membership fees and dues	917,602	1,192,729
Advertising and publicity	559,152	436,099
Fines, penalties and other charges	48,527	171,991
Donations and charitable contributions	87,858	142,620
Periodicals and magazines	101,535	135,654
Miscellaneous expenses	487,694	1,111,000
	373,048,225	390,087,263

27. RELATED PARTY TRANSACTIONS

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

The loan granted by the Bank to its mother corporation, PPC on December 11, 2006 and July 31, 2008 has an outstanding balance of P127,561 million as at December 31, 2012. The loan is fully secured by deposit hold-out of peso and dollar deposits with the Bank. Payments of monthly amortizations were effected through offsetting of the building rentals.

The total DOSRI loan as at December 31, 2012 is P142.293 million.

28. 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.

29. 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.

30. AUTHORITY TO ISSUE FINANCIAL STATEMENTS

As per Stockholders' Resolution No. 2013-01 entitled "CONFIRMATION OF THE 2012 ANNUAL REPORT of the Bank, which contains its 2012 Financial Statements, was presented to and duly confirmed and noted by the Stockholders who were represented by the Board of Directors in the PPSBI's 17th Annual Stockholders' Meeting held on April 30, 2013.

31. RECLASSIFICATION OF ACCOUNTS

Certain accounts in the financial statements were reclassified to conform with the current year's presentation.