BPI Direct BanKo, Inc., A Savings Bank

(Formerly BPI Direct Savings Bank, Inc.)

Foreign Currency Deposit Unit

Financial Statements
As at and for the years ended December 31, 2018 and 2017

Isla Lipana & Co.

Independent Auditor's Report

To the Board of Directors and Shareholder of
BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
G/F BanKo Center Building
Ortigas Avenue, North Greenhills
San Juan, Metro Manila

Report on the Audits of the Financial Statements

Our Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Foreign Currency Deposit Unit of BPI Direct BanKo, Inc., A Savings Bank (formerly BPI Direct Savings Bank, Inc.) (the "Bank") as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with the reporting guidelines of the Bangko Sentral ng Pilipinas, as shown by the books maintained in the Philippines.

What we have audited

The financial statements of the Bank comprise:

- the statements of condition as at December 31, 2018 and 2017;
- the statements of income for the years ended December 31, 2018 and 2017;
- the statements of comprehensive income for the years ended December 31, 2018 and 2017;
- the statements of changes in due to regular banking unit for the years ended December 31, 2018 and 2017;
- the statements of cash flows for the years ended December 31, 2018 and 2017; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for Opinion

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

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

Independence

We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics), together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics.

Emphasis of Matter - Basis of Accounting and Restriction on Use

We draw attention to Note 10 to the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the reporting guidelines prescribed by the Bangko Sentral ng Pilipinas. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the information and use of the management of the Bank, and for purposes of submission to the Bangko Sentral ng Pilipinas and the Bureau of Internal Revenue and is not intended for any other purpose. Our opinion is not modified in respect of this matter.

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

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Isla Lipana & Co.

Ruth F. Blasco
Partner
CPA Cert. No. 112595
P.T.R. No. 0018519, issued on January 8, 2019, Makati City
SEC A.N. (individual) as general auditors 1653-A, Category A; effective until August 23, 2020
SEC A.N. (firm) as general auditors 0009-FR-5, Category A; effective until June 20, 2021
TIN 235-725-236
BIR A.N. 08-000745-133-2017, issued on June 8, 2017; effective until June 7, 2020
BOA/PRC Reg. No. 0142, effective until September 30, 2020

Makati City
March 29, 2019

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Condition
December 31, 2018 and 2017
(All amounts in Philippine Peso)

	Notes	2018	2017
RESOURCES			
Due from other banks	2,7	339,118,419	436,445,262
Other resources		186,191	154,030
Total resources		339,304,610	436,599,292
LIABILITIES AND DUE TO REGULAR BANKING UNIT			
Deposit liabilities	3	324,942,353	426,793,847
Accrued taxes, interest and other expenses		50,887	32,177
Other liabilities		14,263,529	9,038,886
Total liabilities		339,256,769	435,864,910
Due to regular banking unit		47,841	734,382
Total liabilities and due to regular banking unit		339,304,610	436,599,292

(The notes on pages 1 to 20 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Income
For the years ended December 31, 2018 and 2017
(All amounts in Philippine Peso)

	Notes	2018	2017
Interest income on deposits with banks	2	2,492,653	2,472,895
Interest expense on deposit liabilities	3	(725,462)	(798,902)
Net interest income		1,767,191	1,673,993
Service fee income	4	1,491,172	1,216,724
Miscellaneous expenses	5	(2,790,663)	(1,896,212)
Income before income tax		467,700	994,505
Income tax expense	6	(419,859)	(260,123)
Net income for the year		47,841	734,382

(The notes on pages 1 to 20 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017
(All amounts in Philippine Peso)

	2018	2017
Net income for the year	47,841	734,382
Other comprehensive income	-	-
Total comprehensive income for the year	47,841	734,382

(The notes on pages 1 to 20 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Changes in Due to Regular Banking Unit
For the years ended December 31, 2018 and 2017
(All amounts in Philippine Peso)

	2018	2017
Balances at January 1	734,382	1,644,322
Comprehensive income		
Net income for the year	47,841	734,382
Other comprehensive income	-	-
Total comprehensive income for the year	47,841	734,382
Transfers to regular banking unit	(734,382)	(1,644,322)
Balances at December 31	47,841	734,382

(The notes on pages 1 to 20 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Statements of Cash Flows
For the years ended December 31, 2018 and 2017
(All amounts in Philippine Peso)

	Notes	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax		467,700	994,505
Adjustments for:			
Interest income on deposits with banks	2	(2,492,653)	(2,472,895)
Interest received on deposits with banks		2,458,829	2,464,617
Interest expense on deposit liabilities	3	725,462	798,902
Interest paid on deposit liabilities		(706,752)	(785,815)
Changes in operating assets/liabilities			
Increase in other resources		1,663	(1,906)
Increases in:			
Deposit liabilities		(101,851,494)	10,616,445
Other liabilities		5,224,643	3,456,489
Net cash (used in) from operations		(96,172,602)	15,070,342
Income taxes paid	6	(419,859)	(260,123)
Net cash (used in) from operating activities		(96,592,461)	14,810,219
CASH FLOW FROM FINANCING ACTIVITY			
Transfer to regular banking unit		(734,382)	(1,644,322)
NET (DECREASE) INCREASE IN CASH		(97,326,843)	13,165,897
CASH	2		
January 1		436,445,262	423,279,365
December 31		339,118,419	436,445,262

(The notes on pages 1 to 20 are an integral part of these financial statements.)

BPI Direct BanKo, Inc., A Savings Bank
(Formerly BPI Direct Savings Bank, Inc.)
Foreign Currency Deposit Unit

Notes to the Financial Statements
As at and for the years ended December 31, 2018 and 2017
(All amounts are shown in Philippine Peso, unless otherwise stated)

Note 1 - General information

1.1 Business information

BPI Direct BanKo, Inc., A Savings Bank (the "Bank"), formerly known as BPI Direct Savings, Inc. ("BPI Direct"), was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on September 26, 1986 primarily to engage in and carry on the general business of savings and mortgage banking.

The Foreign Currency Deposit Unit (FCDU) license was granted to the Bank on October 31, 2008.

The Bank is a wholly-owned subsidiary of Bank of the Philippine Islands (BPI or the "Parent Bank"), a domestic commercial bank with an expanded banking license, which is also its ultimate parent.

The Bank's registered office address, which is also its principal place of business, is BanKo Center Building, Ortigas Avenue, North Greenhills, San Juan, Metro Manila. The Bank has 1,851 regular employees as at December 31, 2018 (2017 - 951).

1.2 Common control business combination

On February 24, 2016, the Board of Directors of the Bank approved the merger with BPI Globe BanKo, Inc. ("BanKo"), a fellow subsidiary, with the Bank as the surviving entity. BanKo was incorporated in the Philippines and registered with the SEC on June 26, 1998 primarily to engage in, and carry on, the general business of savings and mortgage banking. BanKo was a wholly-owned subsidiary of BPI effective September 20, 2016.

The merger is aimed at integrating the banking operations of BanKo into the Bank and at bringing efficiency and scale to the surviving entity. The merged business is expected to leverage on a bigger customer base and will benefit from cost-savings and operational synergies.

The plan of merger was cleared by the BanKo Sentral ng Pilipinas (BSP) on December 15, 2016. On December 29, 2016, the SEC likewise approved the merger including the amendment to the Bank's articles of incorporation changing the name of the Bank from BPI Direct Savings Bank, Inc. to BPI Direct BanKo, Inc., A Savings Bank.

As the transaction is outside the scope of PFRS 3, *Business Combinations*, the merger was accounted for using the pooling of interests method following the guidance under the PIC Q&A No. 2011-02 and PIC Q&A 2012-01. In applying the pooling of interests method, all resources and liabilities of BanKo are taken into the merged business at their carrying values with no restatement of comparative 2015 figures. Likewise, no goodwill was recognized in the business combination.

Details of BanKo's assets and liabilities as at December 28, 2016 are as follows:

	Amount
Resources acquired	
Cash and other cash items	5,250,717
Due from other banks	22,449,138
Due from Bangko Sentral ng Pilipinas	73,483,568
Loans and advances, net	102,699,171
Bank premises, furniture, fixtures and equipment, net	21,955,667
Other resources	82,585,931
	308,424,192
Liabilities assumed	
Deposit liabilities	441,251,566
Accrued taxes, interest and other expenses	66,669,507
Other liabilities	39,279,722
	547,200,795
Excess of total liabilities over total resources	(238,776,603)

The plan of merger provides that the Bank shall issue 0.02351 of its own common share for every common share held by BanKo shareholders. Accordingly, the Bank issued a total of 310,388 common shares in exchange for BanKo's resources and liabilities at December 28, 2016 giving rise to Other reserves (with debit balance) which is presented as a deduction in the total equity of the Bank as follows:

	Note	Amount
Equity instruments issued (13,200,000 BanKo shares x 0.02351)		310,388
Par value per share		100
Total value of common shares issued		31,038,800
Net liabilities assumed		(238,776,603)
Other reserves (deduction in equity)		269,815,403

Had the business combination occurred on January 1, 2016, total interest income and net income of the Bank for the year ended December 31, 2016 would have been P652,421,959 and P267,827,753, respectively.

The acquisition of BanKo's operations contributed interest income of P198,821 and net loss of P1,158,211 to the Bank for the period from December 29 to 31, 2016. Acquisition-related costs of P155,194 that were not directly attributable to the issue of shares were included in other operating expenses in the statement of income.

1.3 Approval of the Bank's financial statements

These financial statements have been approved and authorized for issuance by the Board of Directors (BOD) on March 27, 2019. There are no material events that occurred subsequent to March 27, 2019 until March 29, 2019.

Note 2 - Due from other banks

The account consists of deposits with the Parent Bank and a fellow subsidiary amounting to P339,118,419 at December 31, 2018 (2017 - P436,445,262).

Interest income recognized on deposits with banks amounts to P2,492,653 for the year ended December 31, 2018 (2017 - P2,472,895).

Note 3 - Deposit liabilities

The account consists of savings deposits amounting to P324,942,353 at December 31, 2018 (2017 - 426,793,847). All of which are payable on demand.

Interest expense recognized on deposit liabilities amounts to P725,462 for the year ended December 31, 2018 (2017 - P798,902).

Note 4 - Service fee income

The account consists of service charges on deposit accounts for failure to meet minimum balance requirements and foreign exchange gains which amount to P1,491,172 for the year ended December 31, 2018 (2017 - P1,216,724).

Note 5 - Miscellaneous expenses

The account mainly includes allocated costs from the Bank's regular banking unit which amounts to P2,790,663 for the year ended December 31, 2018 (2017 - P1,896,212).

Note 6 - Income taxes

Income subject to tax for the year ended December 31 consists of revenue generated from on-shore transactions of the FCDU.

A reconciliation between the income tax expense at the statutory income tax rate to the actual income tax expense for the years ended December 31 are as follows:

	2018		2017	
	Amount	Rate (%)	Amount	Rate (%)
Statutory income tax	140,310	30.00	298,352	30.00
Effects of items not subjected to statutory tax rate				
Non-deductible expense	1,173,964	251.01	518,172	52.10
Income subjected to lower tax rates	(894,415)	(191.24)	(556,401)	(55.95)
Income tax expense	419,859	89.77	260,123	26.15

Note 7 -Related party transactions

In the ordinary course of business, the Bank has transactions with the Parent Bank and other related entities which are recognized in the FCDU books. These transactions usually arise from normal banking activities such as deposit arrangements and outsourcing of certain services primarily loans operations, branch operations and human resource-related functions. These transactions are done on an arm's length basis and are made substantially on the same terms and conditions as transactions with unaffiliated individuals and businesses of comparable risks under the same or similar circumstance.

Significant related party transactions at December 31, 2018 of the FCDU pertain to deposits with the Parent Bank and a fellow subsidiary amounting to P339,118,419 (2017 - P436,445,262).

Note 8 - Other commitments and contingent liabilities

The Bank, including the FCDU, has no outstanding commitments and contingent liabilities as at December 31, 2018 and 2017.

Note 9 - Financial risk and capital management

Risk management in the Bank, including the FCDU, covers all perceived areas of risk exposure, even as it continuously endeavors to uncover hidden risks. Capital management is understood to be a facet of risk management. The Board of Directors is the Bank's principal risk and capital manager and the Bank's only strategic risk taker. The Board of Directors provides written policies for overall risk management, as well as written procedures for the management of foreign exchange risk, interest rate risk, credit risk, equity risk, and contingency risk, among others.

The primary objective of the Bank is the generation of recurring acceptable returns to shareholders' capital. To this end, the Bank's policies, business strategies, and business activities are directed towards the generation of cash flows that are in excess of its fiduciary and contractual obligations to its depositors, and to its various other funders and stakeholders.

To generate acceptable returns to its shareholder's capital, the Bank understands that it has to bear risk, that risk-taking is inherent in its business. Risk is understood by the Bank as the uncertainty in its future income - an uncertainty that emanates from the possibility of incurring losses that are due to unplanned and unexpected drops in revenues, increases in expenses, impairment of asset values, or increases in liabilities.

The possibility of incurring losses is, however, compensated by the possibility of earning more than expected income. Risk-taking is, therefore, not entirely a bad step to be avoided. Risk-taking presents opportunities if risks are accounted, deliberately taken, and are kept within rationalized limits.

The Risk Management Office (RMO) is responsible for the management of market and liquidity risks. Its objective is to minimize adverse impacts on the Bank's financial performance due to the unpredictability of financial markets. Market and credit risks management in the Bank is carried out through policies approved by the Risk Management Committee (RMC) and the Board of Directors. In addition, Internal Audit is responsible for the independent review of risk assessment measures and procedures and the control environment. For risk management purposes, risks emanating from Treasury activities are managed independently.

The most important risks that the Bank manages are credit risk, liquidity risk, market risk and other operational risks. Market risk includes currency exchange risk, interest rate and other price risks.

9.1 Credit risk

The Bank, including the FCDU, takes on exposure to credit risk, which is the risk that may arise if a borrower or counterparty fails to meet its obligations in accordance with agreed terms. Credit risk is the single largest risk for the Bank's business; management therefore carefully manages its exposure to credit risk as governed by relevant regulatory requirements and international benchmarks.

Credit exposure in the FCDU arises principally from loans and advances consisting of Due from other banks. The Credit Policy Group works with the Credit Committee in managing credit risks, and reports are regularly provided to the Board of Directors.

The maximum credit risk exposure relates to Due from other banks which amounts to P339,118,419 at December 31, 2018 (2017 - P436,445,262) is deposited in a universal and a thrift bank and is considered fully performing (Note 2). Deposits are made in the reputable banks with good credit ratings. Management has determined that there is a low risk of default on these deposits and has assessed that the said counterparties have strong capacity to meet its contractual cash flow obligations in the near term. Under Philippine Financial Reporting Standard (PFRS) 9, low credit risk assets are at a minimum subject to 12-month expected credit loss (ECL). Based on its assessment, management has ascertained that the corresponding 12-month ECL is not material.

9.2 Market risk

The Bank, including the FCDU, is exposed to market risk, the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

Market risk management is incumbent on the Board of Directors through its Risk Management Committee (RMC).

9.2.1 Interest rate risk

There are two types of interest rate risk - (i) fair value interest risk and (ii) cash flow interest risk. Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank, including the FCDU, takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates. Interest margins may increase as a result of such changes but may also result in losses in the event that unexpected movements arise.

The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily by the Risk Management Office.

Interest rate risk in the banking book arises from the Bank's core banking activities. The main source of this type of interest rate risk is repricing risk, which reflects the fact that the Bank's assets and liabilities are of different maturities and are priced at different interest rates.

The FCDU's financial assets and liabilities as at December 31 are all non-repricing and are broken down as follows:

	2018	2017
Financial assets		
Due from other banks	339,118,419	436,445,262
Other resources	186,191	154,030
Total financial assets	339,304,610	436,599,292
Financial liabilities		
Deposit liabilities	324,942,353	426,793,847
Accrued interest payable	50,887	32,177
Total financial liabilities	324,993,240	426,826,024
Total interest repricing gap	14,311,370	9,773,268

9.2.2 Foreign currency exchange risk

Foreign currency exchange risk is being managed on a Bank-wide basis. As at December 31, 2018 and 2017, the FCDU of the Bank is not engaged in transactions denominated in currencies other than its functional currency, US Dollar. Accordingly, it has no exposure to foreign currency exchange risk.

9.3 Liquidity risk

Liquidity risk is the risk that the Bank, including the FCDU, is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfill commitments to lend.

The Bank's liquidity management process, as carried out within the Bank and monitored by the RMC and the RMO includes:

- day-to-day funding, which includes replenishment of funds as they mature or are borrowed by customers, managed by monitoring future cash flows to ensure that requirements can be met;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- managing the concentration and profile of debt maturities; and
- performing periodic liquidity stress testing on the Bank's liquidity position by assuming a faster rate of withdrawals in its deposit base.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.

Sources of liquidity are regularly reviewed by the Bank to maintain a wide diversification by currency, geography, counterparty, product and term. Assets available to meet all of the liabilities include due from other banks. The Bank would also be able to meet unexpected net cash outflows by accessing additional funding sources.

The FCDU's financial liabilities at December 31, 2018 consisting of savings deposits amounting to P324,942,353 (2017 - P426,793,847) have no stated maturity and are repayable on demand.

The Bank has sufficient liquid assets (mainly Due from other banks) to meet its obligation.

9.4 Fair values of financial assets and liabilities

The table below summarizes the carrying amounts and fair values of those financial assets and liabilities at December 31 not presented in the statement of condition at fair value.

	Carrying Value		Fair Value	
	2018	2017	2018	2017
Financial assets				
Due from other banks	339,118,419	436,445,262	339,118,419	436,445,262
Other resources	186,191	154,030	186,191	154,030
Financial liabilities				
Deposit liabilities	324,942,353	426,793,847	324,942,353	426,793,847
Accrued interest payable	50,887	32,177	50,887	32,177

Due from other banks

The fair value of floating rate placements and overnight deposits approximates their carrying amount. The estimated fair value of fixed interest-bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Deposit liabilities

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

The carrying amount of deposit liabilities approximates their fair value due to the short-term nature of these instruments.

Other resources/liabilities

Carrying amounts of other resources/liabilities which have no definite repayment dates are assumed to be their fair values.

9.5 Capital management

Capital management is understood to be a facet of risk management. The primary objective of the Bank is the generation of recurring acceptable returns to shareholders' capital. To this end, the Bank's policies, business strategies and activities are directed towards the generation of cash flows that are in excess of its fiduciary and contractual obligations to its depositors, and to its various funders and stakeholders.

Cognizant of its exposure to risks, the Bank understands that it must maintain sufficient capital to absorb unexpected losses, to stay in business for the long haul, and to satisfy regulatory requirements. The Bank further understands that its performance, as well as the performance of its various units, should be measured in terms of returns generated vis-à-vis allocated capital and the amount of risk borne in the conduct of business.

Effective January 1, 2014, the BSP, through its Circular 781, requires each bank and its financial affiliated subsidiaries to adopt new capital requirements in accordance with the provisions of Basel III. The new guidelines are meant to strengthen the composition of the bank's capital by increasing the level of core capital and regulatory capital. The Circular sets out minimum Common Equity Tier 1 (CET1) ratio and Tier 1 Capital ratios of 6% and 7.5%, respectively. A capital conservation buffer of 2.5%, comprised of CET1 capital, was likewise imposed. The minimum required capital adequacy ratio remains at 10% which includes the capital conservation buffer.

The table below summarizes the CAR (combined FCDU and regular banking books) under the Basel III framework for the years ended December 31:

	2018	2017
Tier 1 capital	2,368,682,739	2,047,202,631
Tier 2 capital	93,316,281	39,560,975
Gross qualifying capital	2,461,999,020	2,086,763,606
Less: Required deductions	264,091,514	307,424,076
Total qualifying capital	2,197,907,506	1,779,339,530
Risk weighted assets	10,528,451,664	5,249,351,544
CET1	19.99%	33.14%
CAR (%)	20.88%	33.90%

The Bank has fully complied with the CAR requirement of the BSP.

Note 10 - Summary of Significant Accounting Policies

The accompanying financial statements reflect the accounts maintained by the FCDU of the Bank. The principal accounting policies applied in the preparation of the financial statements of the FCDU of the Bank are set out below. These policies have been consistently applied to both years presented, unless otherwise stated.

10.1 Basis of preparation

The financial statements of the FCDU have been prepared in accordance with the reporting guidelines of the BSP. In general, the said guidelines as they relate to the preparation and presentation of the FCDU financial statements of banks, include all applicable Philippine Financial Reporting Standards (PFRSs), Philippine Accounting Standards (PAS), and interpretations approved by the Financial Reporting Standards Council (FRSC) and adopted by the SEC, except with respect to the determination and translation of functional currency as discussed in Note 10.9.

The financial statements of the FCDU of the Bank have been prepared under the historical cost convention.

The preparation of financial statements in conformity with PFRSs 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. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank's financial statements therefore present the financial position and results fairly. There are no areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements.

10.1.1 New standards, interpretations and amendments to published standards

(a) New standards adopted by the Bank

The Bank, including the FCDU, has adopted the following standards effective January 1, 2018:

- *PFRS 15, 'Revenue from contracts with customers'* replaces PAS 18, *'Revenue'* which covers contracts for goods and services and PAS 11, *'Construction contracts'* which covers construction contracts. The new standard is based on the principle that revenue is recognized when control of a good or service transfers to a customer - so the notion of control replaces the existing notion of risks and rewards.

  A new five-step process must be applied before revenue can be recognized: (1) identify contracts with customers, (2) identify the separate performance obligation, (3) determine the transaction price of the contract, (4) allocate the transaction price to each of the separate performance obligations, and (5) recognize the revenue as each performance obligation is satisfied.

  The adoption of PFRS 15 did not have a material impact on the FCDU's financial statements.

- *PFRS 9, 'Financial instruments'* replaces the provisions of PAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

  As permitted by the transitional provisions of PFRS 9, the Bank elected not to restate comparative figures. Resulting adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognized in the opening balance of Surplus as at January 1, 2018.

  The adoption of PFRS 9 has resulted in changes mainly in the Bank's accounting policies for recognition, classification and measurement and impairment of financial assets. There were no changes in the classification of financial liabilities. PFRS 9 also significantly amends other standards dealing with financial instruments such as PFRS 7, *'Financial Instruments: Disclosures'*.

There is no impact on the classification and measurement of financial as the FCDU's financial assets classified as loans and receivables under PAS 39 remain to be at amortized cost.

The hedge accounting rules of PFRS 9 do not have significant impact on the FCDU's financial statements as the FCDU has no formal hedge relationships as at January 1, 2018.

Meanwhile, the Bank, including the FCDU, shifted from the incurred loss model under PAS 39 to the ECL model in the determination of impairment provisions for financial assets not carried at fair value through profit or loss upon adoption of PFRS 9. Management has assessed that the ECL measurement did not result into a recognition of allowance for impairment as at January 1, 2018.

(b) *New standards, interpretations and amendments not yet effective and not yet adopted by the Bank*

The following new standards and interpretations are not mandatory for December 31, 2018 reporting period and have not been early adopted by the Bank, including the FCDU:

- *PFRS 16, Leases (effective for annual periods beginning on or after January 1, 2019)*

  PFRS 16 will replace the current guidance in PAS 17, '*Leases*'. PFRS 16 which will become effective on January 1, 2019 will affect primarily the accounting by lessees and will result in the recognition of almost all leases on balance sheet. PFRS 16 removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. Under PFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. An optional exemption exists for short-term and low-value leases.

  The adoption of PFRS 16 will likely affect the accounting for long-term operating lease agreements of the Bank. The financial impact is currently being finalized by management.

- *Philippine Interpretation IFRIC-23, Uncertainty over Income Tax Treatments (effective for annual periods beginning on or after January 1, 2019)*

  It has been clarified previously that PAS 12, '*Income Taxes*' not PAS 37, '*Provisions, Contingent Liabilities and Contingent Assets*', applies to accounting for uncertain income tax treatments. IFRIC 23 explains how to recognize and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

  An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

  The adoption of the above interpretation will not have a material impact on the FCDU's financial statements.

There are no other standards, amendments or interpretations that are expected to have a material impact on the FCDU's financial statements.

10.2 Business combination between entities under common control

Business combinations under common control are accounted for using the predecessor cost method following the guidance under the PIC Q&A No. 2011-02 and PIC Q&A 2012-01. Under this method, the Bank does not restate the acquired businesses or assets and liabilities to their fair values. The net assets of the combining entities or businesses are combined using the carrying amounts of assets and liabilities of the acquired entity. No amount is recognized in consideration for goodwill or the excess of acquirer's interest in the net fair value of acquired identifiable assets, liabilities and contingent liabilities over their cost at the time of the common control combination.

The financial statements incorporated the net assets and results of operations of the combining entities or businesses at the date of acquisition. The difference between the consideration given and the aggregate book value of the assets and liabilities acquired as of the date of the transaction are included in "Other reserves" under the equity account.

10.3 Financial assets

10.3.1 Cash

Cash and cash equivalents consist of deposits with the Parent Bank and a related subsidiary.

Accounting policies applied from January 1, 2018 (PFRS 9)

10.3.2 Classification

From January 1, 2018, the Bank, including the FCDU, has applied PFRS 9 and classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value through profit or loss (FVTPL);
- those to be measured subsequently at fair value through other comprehensive income (FVOCI); and
- those to be measured at amortized cost.

The classification depends on the Bank's business model for managing the financial assets and the contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in equity instruments that are not held for trading, this will depend on whether the Bank, including the FCDU, has made an irrevocable election at the time of initial recognition to account for the equity investment at FVOCI.

10.3.3 Recognition and measurement

Regular way purchases and sales of financial assets are recognized on trade-date, the date on which the Bank commits to purchase or sell the asset. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and the Bank has transferred substantially all the risks and rewards of ownership.

The classification requirements for debt and equity instruments are described below:

At initial recognition, the Bank, including the FCDU, measures a financial asset at its fair value plus, in the case of a financial asset not at FVTPL, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in profit or loss.

Based on these factors, the Bank, including the FCDU, classifies its debt instruments into one of the following three measurement categories:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse. Subsequent measurement of debt instruments depends on the FCDU's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the FCDU classifies its debt instruments:

- *Amortized cost*
  Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at fair value through profit or loss, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

  Amortized cost financial assets of the FCDU as at January 1, 2018 and December 31, 2018 include due from other banks (Note 2) and other resources.

- *FVOCI*
  Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost which are recognized in the statements of income. When the financial asset is derecognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

  The FCDU does not hold financial assets at FVOCI as at January 1, 2018 and December 31, 2018.

- *FVTPL*
  Assets that do not meet the criteria for amortized cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented in the statements of income within Trading gain on securities in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately.

  The FCDU does not hold financial assets at FVTPL as at January 1, 2018 and December 31, 2018.

Business model: The business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable, then the financial assets are classified as part of 'other' business model and measured at fair value through profit or loss. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

The FCDU reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets.

The Bank subsequently measures equity investments at FVTPL, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognized in other comprehensive income and are not subsequently reclassified to profit or loss, even on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognized in profit or loss as other income when the Bank's right to receive payments is established. Gains and losses on equity investments at fair value through profit or loss are included in the Trading gain on securities in the statements of income.

The FCDU does not hold equity instruments as at January 1, 2018 and December 31, 2018.

10.3.3 Impairment and write-off

The Bank, including the FCDU, assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at fair value through other comprehensive income and amortized cost. The Bank, including the FCDU, recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The, FCDU's financial asssets pertain to due from other banks and other resources, The FCDU applies the simplified approach, as permitted by PFRS 9, in measuring ECL which uses a lifetime expected loss allowance for other financial assets.

To measure the expected credit losses, other financial assets have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of receivables over a period of 36 month before January 1, 2018 or December 31, 2018 respectively, and corresponding historical credit losses experienced within this periods. The forward-looking information on macroeconomic factors are considered insignificant in calculating impairment of the FCDU's financial assets.

Write-off

Financial assets are written-off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the FCDU and a failure to make contractual payments for a period of greater than 120 days past due.

10.3.4 Derecognition

A financial asset is derecognized when the contractual right to receive the cash flows from the asset has ceased to exist or the asset has been transferred and substantially all the risks and rewards of ownership of the asset are also transferred (that is, if substantially all the risks and rewards have not been transferred, the FCDU tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition).

Accounting policies applied until December 31, 2017 (PAS 39)

10.3.5 Classification

The Bank, including the FCDU, classifies its financial assets in the following categories: fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale securities. The classification depends on the purpose for which the financial assets are acquired. Management determines the classification of its investments at initial recognition.

As at December 31, 2017, the Bank, including the FCDU, has no financial assets classified at fair value through profit or loss, held-to-maturity investments and available-for-sale securities.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and with no intention of trading. Due from other banks fall under this category.

10.3.6 Recognition and measurement

Loans and receivables are recognized when cash is advanced to the borrowers. Loans and receivables are initially recognized at fair value plus transaction costs. Loans and receivables are subsequently carried at amortized cost using the effective interest method.

10.3.7 Impairment

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

The criteria that the Bank, including the FCDU, uses to determine that there is an objective evidence of impairment include:

- delinquency in contractual payments of principal or interest;
- cash flow difficulties experienced by the borrower;
- breach of loan covenants or conditions;
- initiation of bankruptcy proceedings;
- deterioration of the borrower's competitive position; and
- deterioration in the value of collateral.

The Bank, including the FCDU, first assesses whether an objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Financial assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

The amount of impairment loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (recoverable amount). The calculation of recoverable amount of a collateralized financial asset reflects the cash flows that may result from foreclosure less cost of obtaining and selling the collateral, whether or not foreclosure is probable. Impairment loss is recognized in the statement of income and the carrying amount of the asset is reduced through the use of an allowance.

For purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the statement of income as a reduction of impairment losses for the year.

10.3.8 Derecognition

A financial asset is derecognized when the contractual right to receive the cash flows from the asset has ceased to exist or the asset has been transferred and substantially all the risks and rewards of ownership of the asset are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank, including the FCDU, tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition).

Accounting policies applied for both years

10.4 Financial liabilities

10.4.1 Classification

The Bank classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss, and financial liabilities at amortized cost. As at December 31, 2018 and 2017, the Bank has no financial liabilities classified at fair value through profit or loss.

Financial liabilities measured at amortized cost include deposit liabilities and accrued interest payable.

10.4.2 Recognition and measurement

Initial recognition and measurement

Financial liabilities that are not classified at fair value through profit or loss are measured at amortized cost.

Derecognition

A financial liability (or a part of a financial liability) is removed from the statement of condition when, and only when, it is extinguished, i.e., when the obligation is discharged or is cancelled or expires.

10.5 Fair value measurement

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

The fair value of a non-financial asset is measured based on its highest and best use. The asset's current use is presumed to be its highest and best use.

The fair value of financial and non-financial liabilities takes into account non-performance risk, which is the risk that the entity will not fulfill an obligation.

The Bank, including the FCDU, classifies its fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Philippine Stock Exchange, Inc., Philippine Dealing and Exchange Corp., etc.).

- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

- Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. The Bank has no assets or liabilities classified under Level 3 as at December 31, 2018 and 2017.

The appropriate level is determined on the basis of the lowest level input that is significant to the fair value measurement.

(a) Financial instruments

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes mainly from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

(b) Non-financial assets or liabilities

The Bank, including the FCDU, uses valuation techniques that are appropriate in the circumstances and applies the technique consistently. Commonly used valuation techniques are as follows:

- Market approach - A valuation technique that uses observable inputs, such as prices, broker quotes and other relevant information generated by market transactions involving identical or comparable assets or group of assets.
- Income approach - A valuation technique that converts future amounts (e.g., cash flows or income and expenses) to a single current (i.e., discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
- Cost approach - A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

The fair values were determined in reference to observable market inputs reflecting orderly transactions, i.e. market listings, published broker quotes and transacted deals from similar and comparable assets, adjusted to determine the point within the range that is most representative of the fair value under current market conditions.

10.6 Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

As at December 31, 2018 and 2017, there are no financial assets and liabilities that have been offset.

10.7 Interest income and expense

Interest income and expense are recognized in the statement of income for all interest-bearing financial instruments using the effective interest method.

When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount future cash flows for the purpose of measuring impairment loss.

10.8 Foreign currency translation

Functional and presentation currency

Items in the financial statements are measured using the currency of the primary economic environment in which the FCDU operates (the functional currency). In accordance with BSP Circular 601, series of 2008, the functional currency of the FCDU is US Dollar while the financial statements are presented in Philippine Peso (the presentation currency).

The results and financial position of the FCDU are translated into Philippine Peso as follows:

- resources and liabilities are translated at closing rate at year-end;
- income and expenses are translated at exchange rates at the dates of the transactions; and
- all resulting exchange differences are taken to statement of comprehensive income under cumulative translation adjustment.

Management assessed that the impact of the translation adjustment is insignificant and decided not to present the cumulative translation adjustment separately in the FCDU's financial statements.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss. Non-monetary items measured at historical cost denominated in a foreign currency are translated at exchange rate as at the date of initial recognition. Non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rate at the date when the fair value is determined.

10.9 Service fee income

Fees and commissions, mainly representing service fees, are recognized on an accrual basis when the service has been provided. Fees and commission arising from banking transactions are recognized as income based on agreed terms and conditions.

10.10 Income taxes

Income earned by the FCDU is taxed as follows: (a) offshore income is tax-exempt, (b) gross onshore income is taxed at 10%, and (c) all other income not classifiable as onshore or offshore subject to the regular corporate tax rate of 30% of net taxable income.

Income derived by the FCDU from foreign currency transactions with local commercial banks, including branches of foreign banks authorized by the BSP to transact business with the FCDU is subject to 10% final tax. Also, interest earned on deposits with foreign currency denominated units of other banks is subject to 15% final tax (2017 - 7.5%).

10.11 Related party relationships and transactions

Related party relationship exists when one party has the ability to control, directly, or indirectly through one or more intermediaries, the other party or exercises significant influence over the other party in making financial and operating decisions. Such relationship also exists between and/or among entities which are under common control with the reporting enterprise, or between and/or among the reporting enterprise and its key management personnel, directors, or its shareholders. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

10.12 Events after the reporting date

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