

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES
REGULATION CODE AND SRC RULE 17(2)(b) THEREUNDER

1. For the quarterly period ended June 30, 2013
2. Commission identification number A1997-9587 3. BIR Tax Identification No. 005-338
421-000
4. Exact name of issuer as specified in its charter: Citystate Savings Bank, Inc.
Makati City, Metro Manila, Philippines
5. Province, country or other jurisdiction of incorporation or organization
6. Industry Classification Code: (SEC Use Only)
7. Address of issuer's principal office Citystate Centre Building, 709 Shaw Boulevard, Pasig City 1600
Postal Code
8. Issuer's telephone number, including area code (632) 470-3333
9. Former name, former address and former fiscal year, if changed since last report
10. Securities registered pursuant to Sections 8 and 12 of the Code, or Sections 4 and 8 of the
RSA

Title of each Class	Number of shares of common stock outstanding and amount of debt outstanding
<u>Common Stock</u>	<u>72,764,998</u>

11. Are any or all of the securities listed on a Stock Exchange?

Yes [] No []

If yes, state the name of such Stock Exchange and the class/es of securities listed therein:

Philippine Stock Exchange Common Stock

12. Indicate by check mark whether the registrant:

(a) has filed all reports required to be filed by Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period the registrant was required to file such reports).

Yes [] No []

(b) has been subject to such filing requirements for the past ninety (90) days.

Yes [] No []

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CSBI's unaudited "interim" financial statements are shown in Annex "A" of this report comprising of the following:

- a) Consolidated Statements of Condition as of June 30, 2013 and December 31, 2012;
- b) Consolidated Statements of Income and Expenses for the quarter ended June 30, 2013 (with comparative figures for the same period ended June 30, 2012);
- c) Consolidated Statements of Income and Expenses for the six months ended June 30, 2013 (with comparative figures for the same period ended June 30, 2012);
- d) Consolidated Statements of Changes in Equity for the quarter ended June 30, 2013 (with comparative figures for the period ended June 30, 2012);
- e) Consolidated Statement of Cash Flow for the period ended June 30, 2013 (with comparative figures for the quarter ended June 30, 2012);
- f) Notes to the Financial Statements.

The unaudited "interim" financial statements of CSBI reflect all adjustments which are of normal recurring nature that transpired during the quarter ended June 30, 2013. The bank followed the same accounting policies and methods of computation in the "interim" financial statements as compared with the most recent annual financial statements.

The interim financial statements were prepared in compliance with generally accepted accounting principles in the Philippines as mandated by the Securities and Exchange Commission.

Item 2. Management's Discussion and Analysis of Financial Condition and Results Of Operations.

For the Period Ended June 30, 2013

Interest Income

Total gross interest income increased by 25.20% after six months of operation in the amount of P138.802 million against last year's P110.867 million. This was mainly due to the 43.41% increase in Loans and Receivables, which jumped from P91.142 million to P130.710 million. This was brought about by the increase in interest income on Time Loan Jewelry. However, Due from BSP and Other Banks dropped to P3.964 million this year from P9.991 million last year ; while Financial Assets at Fair Value Through Profit or Loss fell to P1.128 million from P5.699 million for a 80.21% decrease due to a decrease in the principal amount of the securities. The aforementioned were comparative figures for the semesters ending June 30, 2013 and June 30, 2012.

Interest Expense

Interest Expense on Deposit Liabilities in the second quarter amounting to P7.110 million as compared to last year's figure of P6.415 million increased by 9.77%. For the first semester, Interest Expense was up by P550 million from P13.981 million last year to P14.531 million. The Interest Expense of P14.531 million is 10.47% of the Interest Income of P138.802 million.

Other Income/Expenses

Other Income generated after two quarters amounted to P17.012 million as compared to the P22.327 million generated over the same period last year. This is a result of a significant decrease in Miscellaneous Charges from P14.488 million to P8.544 million due to decrease in gain on auction sale. On the other hand, Service Charges and Fees rose from P7.839 million to P8.468 million.

The Bank's Other Expenses increased to P130.975 million from P113.026 million after six months of operation. This is mainly due to the increase in Employee Benefits which jumped to P48.650 million from P41.675 million as the number of employees increased. Occupancy slightly increased by P60 thousand from P13.337 million to P13.397 million due to escalation rate in rental of some of our branches. Security, Janitorial and Messengerial Services also increased by P3.062 million from P11.727 million to P14.789 million this year due to additional security services for the new branch in Dagupan City which was opened last May 10, 2013. Communication, Light and Water increased by P681 thousand from P10.782 million last year to P11.463 million this year due to increases in the consumption of some of the branches. Insurance inched higher to P6.191 million this year from P4.896 million last year. Part of the increase were various insurance expenses of the newly opened branch.

On the other hand, Taxes and Licenses went up to P7.902 million from P6.086 million for a 23% increase. Likewise, Depreciation and Amortization increased by 3.74% from P6.865

million to P7.132 million. Litigation/Assets acquired increased by P309 thousand from P2.336 million last year to P2.645 million this year. Fuel and Oil also increased by P2.213 million from P2.820 million last year to P5.033 million this year.

Net Income

The Bank posted a P3.855 million quarter income versus last year's quarter income of P5.268 million. This year's semestral net income amounted to P8.953 million as compared to last year's semestral net loss of P7.720 million.

Total Resources

Total Resources increased by P291 million or a 10.28% increase from P2.539 billion to P2.830 billion after six months of operation. This was mainly due to significant increases in Cash and Other Cash Items from P71.712 million to P85.790 million, Due from BSP from P401.087 million to P451.132 million and Due from Other Banks from P104.203 million to P108.574 million. Loans and Receivables were recorded at P1.732 billion higher by 11.89% or P206 million from last year of P1.526 billion. Other Resources increased from P98.969 million to P121.091 million. On the other hand, Available for Sale Securities decreased by 4.92% from P103.763 million to P98.663 this year while Investment Properties declined to P39.968 million this year from P46.536 last year.

Investment Properties is a reliable source of fund for relending, thus management is focused in selling and monetizing these acquired assets.

The bank does not have any transactions on the issuances, repurchases, and repayments of debt and any of its equity securities.

Sources of Funds

Deposit generation provided the main source of loanable funds as Deposit Liabilities increased 13.28% to P1.981 billion from P1.718 billion after six months of operation. This upward trend is expected to continue as marketing programs are adopted to increase deposits and improve on deposit mix to attain higher interest margin.

Marketing Programs

To maintain its competitive advantage in public awareness and to reach a wider scope of audience, the bank will be more aggressive in its advertising campaign through print and radio advertisements in the coming months.

Furthermore, more branches would be opened and new ATM sites would be installed to expand the bank's branch network and ATM facilities.

Key Performance Indicators

The Bank monitors its performance with the other players in the banking industry in terms of the following indicators:

Key Performance Indicators	CSB June 2013	Industry June 2012
<u>Capital Adequacy</u>		
Capital to Risk Assets Ratio	39.68%	15.03%
<u>Asset Quality</u>		
Non-Performing Loan (NPL) Ratio	2.86%	6.15%
Non-Performing Loan (NPL) Cover	60.31%	71.47%
<u>Liquidity</u>		
Loans to Deposit	87.43%	85.76%
<u>Profitability</u>		
Return on Average Equity	0.48%	13.43%
Net Interest Margin	2.51%	5.37%
<u>Cost Efficiency</u>		
Cost to Income	94.23%	94.16%

In terms of stability, the bank continues to benefit from a higher Capital Adequacy Ratio (CAR) of 39.68% versus the industry ratio of 15.03%. The bank's NPL ratio of 2.86% surpassed the industry's 6.15% as it continues to be highly selective in its lending operation and improve on loan collection. Allowance for Probable Losses over Non-performing loans is lower at 60.31% versus the industry's 71.47%.

The bank's loan to deposit ratio of 87.43% is high compared with the thrift banking industry's 85.76%.

In terms of profitability, the bank was outperformed by the thrift banking industry with a Return on Ave. Equity (ROE) of 0.48%, lower than the industry average of 13.43%. Its Net Interest Margin is lower at 2.51% as against the industry's 5.37%.

The bank continues to adopt measures to provide a strong and stable financial condition.

The manner by which the Bank calculates the above indicators is as follows:

Key Performance Indicator	Formula
Capital to Risk Assets Ratio	BSP prescribed formula: $\frac{\text{Total Qualifying Capital}}{\text{Market and Credit Risk Weighted Exposures}}$
Non-performing Loan (NPL) Ratio	$\frac{\text{Non-performing Loans}}{\text{Gross Loans}}$
Non-performing Loan (NPL) Cover	$\frac{\text{Allowance for Probable Losses}}{\text{Non-performing Loans}}$
Loans to Deposits Ratio	$\frac{\text{Total Loans}}{\text{Total Deposits}}$

Return on Average Equity	<u>Net Income After Income Tax</u> <u>Average Total Capital Accounts</u>
Net Interest Margin	<u>Net Interest Income</u> <u>Average Interest Earning Assets</u>
Cost to Income	<u>Total Operating Expenses</u> <u>Net Interest Income + Other Income</u>

A schedule showing financial soundness indicators in two (2) comparative periods is as follows:

	June 2013	June 2012
1. Liquidity Ratio	0.33:1	0.34:1
2. Solvency Ratios		
a) current ratio	0.33:1	0.34:1
b) current liabilities to net ratio	2.53:1	2.27:1
3. Debt-to-equity ratio	2.55:1	2.33:1
4. Asset-to-equity ratio	3.55:1	3.32:1
5. Interest rate Coverage ratio	0.69:1	-0.55:1
6. Profitability Ratio		
a) Return on Asset Ratio	0.54%	(0.60%)
b) Return on Net Worth Ratio	1.90%	(0.50%)

Earnings Per Share

Basic earnings per share are as follows:

	June 30 <u>2013</u>	June 30 <u>2012</u>
Net Income	P 8,952,635	P (7,720,271)
Divided by the number of outstanding shares	<u>72,764,998</u>	<u>72,764,998</u>
Basic earnings per share	<u>0.123</u>	<u>(0.106)</u>

Dividends

No dividends declared during the quarter ended June 30, 2013.

PART II - OTHER INFORMATION

No other information for this period.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Issuer Citystate Savings Bank, Inc.

Signature and Title Ruel L. Angga
Chief Compliance Officer

Date August 13, 2013

Principal Financial/Accounting Officer/Comptroller Eduardo O. Olavario
Vice President

Signature and Title _____

Date August 13, 2013

CITYSTATE SAVINGS BANK, INC.
STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2013 AND DECEMBER 31, 2012
(Amounts in Philippine Pesos)

	<u>2013</u> <u>Unaudited</u>	<u>2012</u> <u>Audited</u>
<u>R E S O U R C E S</u>		
CASH AND OTHER CASH ITEMS	85,790,286	122,574,664
DUE FROM BANGKO SENTRAL NG PILIPINAS	451,131,690	225,855,077
DUE FROM OTHER BANKS	108,574,354	112,890,196
AVAILABLE-FOR-SALE SECURITIES	98,663,374	102,025,957
LOANS AND RECEIVABLES - Net	1,732,336,279	2,000,233,891
BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - Net	192,446,676	189,031,596
INVESTMENT PROPERTIES - Net	39,967,977	34,965,694
OTHER RESOURCES - Net	<u>121,090,767</u>	<u>109,530,952</u>
TOTAL RESOURCES	<u><u>2,830,001,403</u></u>	<u><u>2,897,108,027</u></u>
<u>LIABILITIES AND EQUITY</u>		
DEPOSIT LIABILITIES		
Demand	251,456,199	269,823,523
Savings	1,543,923,410	1,702,958,386
Time	<u>185,600,536</u>	<u>76,252,953</u>
Total Deposit Liabilities	1,980,980,145	2,049,034,862
OTHER LIABILITIES	<u>51,414,873</u>	<u>58,056,832</u>
Total Liabilities	2,032,395,018	2,107,091,694
EQUITY	<u>797,606,385</u>	<u>790,016,333</u>
TOTAL LIABILITIES AND EQUITY	<u><u>2,830,001,403</u></u>	<u><u>2,897,108,027</u></u>

CITYSTATE SAVINGS BANK, INC.
STATEMENTS OF COMPREHENSIVE INCOME
For the Semester Ended June 30, 2013
(With Comparative Figures for the Semester Ended June 30, 2012)
(Amounts in Philippine Pesos)

	<u>2013</u>	<u>2012</u>
INTEREST INCOME		
Loans and receivables	130,710,023	91,142,201
Due from BSP and other banks	3,964,450	9,990,542
Available-for-sale securities	1,738,660	2,839,941
Financial assets at fair value through profit or loss	1,127,952	5,698,875
Held-to-maturity investments	-	-
Others	<u>1,260,842</u>	<u>1,195,922</u>
	138,801,925	110,867,480
INTEREST EXPENSE		
Deposit liabilities	14,530,493	13,981,408
Others	<u>182,325</u>	-
	14,712,818	13,981,408
NET INTEREST INCOME	124,089,107	96,886,072
IMPAIRMENT LOSS (RECOVERY)	<u>-</u>	<u>10,260,204</u>
NET INTEREST INCOME AFTER IMPAIRMENT LOSS AND RECOVERY	124,089,107	107,146,276
OTHER OPERATING INCOME		
Service charges and fees	8,467,814	7,838,668
Miscellaneous	<u>8,544,292</u>	<u>14,488,086</u>
	17,012,107	22,326,754
OTHER EXPENSES		
Employee benefits	48,650,379	41,674,716
Security, janitorial and messengerial services	14,788,632	11,727,159
Occupancy	13,396,584	13,336,910
Communication, light and water	11,463,194	10,782,490
Taxes and licenses	7,901,784	6,085,736
Depreciation and amortization	7,131,598	6,865,291
Insurance	6,191,042	4,895,872
Fuel and oil	5,032,883	2,820,277
Litigation/assets acquired	2,645,478	2,336,218
Repairs and maintenance	2,235,454	1,949,993
Others	<u>11,538,242</u>	<u>10,551,625</u>
	130,975,269	113,026,287
PROFIT (LOSS) BEFORE TAX	10,125,945	(4,073,664)
TAX EXPENSE	<u>1,173,310</u>	<u>1,173,310</u>
NET PROFIT (LOSS)	8,952,635	(7,220,271)
OTHER COMPREHENSIVE INCOME		
Fair value gains	<u>(1,362,583)</u>	<u>641,267</u>
TOTAL COMPREHENSIVE INCOME	7,590,051	(7,079,004)
Earnings Per Share	<u><u>0.123</u></u>	<u><u>0.106</u></u>

CITYSTATE SAVINGS BANK, INC.
STATEMENTS OF COMPREHENSIVE INCOME
For the Quarter Ended June 30, 2013
(With Comparative Figures for the Quarter Ended June 30, 2012)
(Amounts in Philippine Pesos)

	<u>2013</u>	<u>2012</u>
INTEREST INCOME		
Loans and receivables	64,848,708	46,891,459
Due from BSP and other banks	1,540,620	3,502,185
Available-for-sale securities	708,672	1,297,636
Financial assets at fair value through profit or loss	303,840	2,890,555
Others	<u>637,361</u>	<u>596,280</u>
	68,039,202	55,178,115
INTEREST EXPENSE		
Deposit liabilities	7,110,381	6,414,729
Others	<u>27,426</u>	<u>-</u>
	<u>7,137,807</u>	<u>6,414,729</u>
NET INTEREST INCOME	60,901,395	48,763,386
IMPAIRMENT LOSSES (RECOVERY) - Net	<u>-</u>	<u>(3,931,545)</u>
NET INTEREST INCOME AFTER IMPAIRMENT LOSS AND RECOVERY	<u>60,901,395</u>	<u>52,694,931</u>
OTHER OPERATING INCOME		
Service charges and fees	4,625,976	3,489,508
Miscellaneous	<u>4,936,946</u>	<u>8,802,167</u>
	<u>9,562,923</u>	<u>12,291,675</u>
OTHER EXPENSES		
Employee benefits	25,058,415	21,396,746
Security, janitorial and messengerial services	7,440,779	5,800,193
Occupancy	6,685,928	6,679,664
Depreciation and amortization	4,410,976	3,726,675
Power, light and water	3,570,169	3,612,541
Insurance	2,724,318	2,915,070
Fuel and oil	2,564,431	1,414,628
Communication	2,557,484	1,944,539
Taxes and licenses	2,362,657	3,271,472
Litigation/assets acquired	1,517,160	1,171,242
Others	<u>7,502,383</u>	<u>6,329,601</u>
	<u>66,394,699</u>	<u>58,262,373</u>
PROFIT (LOSS) BEFORE TAX	4,069,618	6,724,233
TAX EXPENSE	<u>215,068</u>	<u>1,456,152</u>
NET PROFIT (LOSS)	3,854,550	5,268,081
OTHER COMPREHENSIVE INCOME		
Fair value gains/(loss) on available-for-sale financial assets	<u>(2,131,466)</u>	<u>391,595</u>
TOTAL COMPREHENSIVE INCOME	<u>1,723,084</u>	<u>5,659,676</u>
Earnings Per Share	<u>0.053</u>	<u>0.072</u>

CITYSTATE SAVINGS BANK, INC.
STATEMENTS OF CHANGES IN EQUITY
FOR THE SEMESTER ENDED JUNE 30, 2013

(With Comparative Figures for the Semester Ended June 30, 2012)

(Amounts in Philippine Pesos)

	<u>2013</u>	<u>2012</u>
CAPITAL STOCK		
Balance at the beginning of the semester	727,649,980	727,649,980
Issuance of additional shares	<u>-</u>	<u>-</u>
Balance at the end of the semester	<u>727,649,980</u>	<u>727,649,980</u>
ADDITIONAL PAID-IN CAPITAL	<u>2,222,444</u>	<u>2,222,444</u>
REVALUATION RESERVES		
Balance at the beginning of the semester	11,539,436	5,039,310
Total Comprehensive Income	(1,362,583)	641,267
Punongbayan Audit Adjustments	<u>(141,513)</u>	<u>-</u>
Balance at the end of the semester	<u>10,035,340</u>	<u>5,680,577</u>
SURPLUS RESERVES		
Reserve for trust operations during the semester	<u>507,697</u>	<u>363,134</u>
RETAINED EARNINGS		
Balance at the beginning of the semester	47,401,380	50,124,055
Net income / (loss)	8,952,635	(7,720,271)
Dividends	-	-
P&A audit adjustments	<u>836,909</u>	<u>(4,374,559)</u>
Balance at the end of the semester	<u>57,190,924</u>	<u>38,029,225</u>
TOTAL CAPITAL FUNDS	<u><u>797,606,385</u></u>	<u><u>773,945,360</u></u>

CITYSTATE SAVINGS BANK, INC.
STATEMENTS OF CASH FLOWS
FOR THE SEMESTER ENDED JUNE 30, 2013
(With Comparative Figures for the Semester Ended June 30, 2012)
(Amounts in Philippine Pesos)

	<u>2013</u>	<u>2012</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit (Loss) before tax	10,125,945	(4,073,664)
Adjustments for:		
Gain from sale of ASS	2,000,000	
Depreciation and amortization	7,131,598	7,446,562
Punong bayan audit adjustments	<u>-</u>	<u>(293,114)</u>
Operating income before working capital changes	19,257,542	3,079,784
(Increase) in FA at FVTPL	-	-
Decrease in loans and receivables	267,897,612	(26,476,412)
(Increase) in investment properties (ROPA)	(5,002,283)	(8,911,128)
(Increase) in other resources	(11,559,815)	(21,510,325)
(Decrease) in deposit liabilities	(68,054,717)	(132,557,373)
Increase in other liabilities	<u>(6,641,959)</u>	<u>7,237,719</u>
Cash generated from (used in) operations	195,896,380	(179,137,735)
Cash paid for income taxes	<u>(1,173,310)</u>	<u>(3,646,607)</u>
Net Cash (Used In) Operating Activities	<u>194,723,070</u>	<u>(182,784,342)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of bank premises, furniture, fixtures and equipment	(10,546,678)	(6,400,784)
Decrease in available-for-sale securities	<u>-</u>	<u>15,817,452</u>
Net Cash Used in Investing Activities	<u>(10,546,678)</u>	<u>9,416,668</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of dividends	-	-
Issuance of capital stock	<u>-</u>	<u>-</u>
Net Cash Used in Financing Activities	<u>-</u>	<u>-</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>184,176,392</u>	<u>(173,367,674)</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE SEMESTER		
Cash and other cash items	122,574,664	93,698,892
Due from Bangko Sentral ng Pilipinas	225,855,077	456,418,925
Due from other banks	<u>112,890,196</u>	<u>200,252,193</u>
	<u>461,319,937</u>	<u>750,370,010</u>
CASH AND CASH EQUIVALENTS AT END OF THE SEMESTER		
Cash and other cash items	85,790,286	71,711,767
Due from Bangko Sentral ng Pilipinas	451,131,690	401,087,334
Due from other banks	<u>108,574,354</u>	<u>104,203,235</u>
	<u>645,496,330</u>	<u>577,002,336</u>

CITYSTATE SAVINGS BANK, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2013 AND DECEMBER 31, 2012
(Amounts in Philippine Pesos)

1 CORPORATE INFORMATION

Citystate Savings Bank, Inc. (the "Bank") was incorporated in the Philippines on May 20, 1997. The Bank obtained a thrift bank license from the Bangko Sentral ng Pilipinas ("BSP") on August 7, 1997 and started operations as such on August 8, 1997. The Bank's common shares were listed in the Philippine Stock Exchange ("PSE") on November 14, 2001. On March 4, 2004, the Bank was authorized by the BSP to engage in quasi - banking functions. The Bank has 26 branches and 29 on-site and 7 off-site automated teller machines strategically located in key cities and municipalities within Metro Manila and provincial areas.

The Bank's registered address, which is also its principal place of business, is located at 2nd Floor, Citystate Centre, 709 Shaw Boulevard, Pasig City.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards

The financial statements of the Bank have been prepared in accordance with Philippine Financial Reporting Standards (PFRSs).

The financial statements have been prepared using the measurement bases specified by PFRS for each type of resource and liability, and income and expense.

(b) Presentation of Financial Statements

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

(c) Functional and Presentation Currency

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

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

2.2 Adoption of New and Amended PFRS

(a) Effective in 2012 that are Relevant to the Bank

In 2012, the Bank adopted the following amendments to PFRS that are relevant to the Bank and effective for financial statements for the annual period beginning on or after July 1, 2011 or January 1, 2012:

PFRS 7 (Amendment)	:	Financial Instruments: Disclosures - Transfers of Financial Assets
PAS 12 (Amendment)	:	Income Taxes - Deferred Tax: Recovery of Underlying Assets

Discussed below are the relevant information about these amended standards.

- (i) PFRS 7 (Amendment), *Financial Instruments: Disclosures - Transfers of Financial Assets*. The amendment requires additional disclosures that will allow users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and, to evaluate the nature of, and risk associated with any continuing involvement of the reporting entity in financial assets that are derecognized in their entirety. The Bank did not transfer any financial asset involving this type of arrangement; hence, the amendment did not result in any significant change in the Bank's disclosures in its financial statements.
- (ii) PAS 12 (Amendment), *Income Taxes - Deferred Tax: Recovery of Underlying Assets*. The amendment introduces a rebuttable presumption that the measurement of a deferred tax liability or asset that arises from investment property measured at fair value under PAS 40, *Investment Property* should reflect the tax consequence of recovering the carrying amount of the asset entirely through sale.

(b) Effective in 2012 that is not Relevant to the Bank

PFRS 1, *First-time Adoption of PFRS*, was amended to provide relief for first-time adopters of PFRS from having to reconstruct transactions that occurred before the date of transition to PFRS and to provide guidance for entities emerging from severe hyperinflation either to resume presenting PFRS financial statements or to present PFRS financial statements for the first time. The amendment became effective for annual period beginning on or after July 1, 2011 but is not relevant to the Bank's financial statements.

(c) Effective Subsequent to 2012 but not Adopted Early

There are new PFRS, amendments, annual improvements and interpretation to existing standards that are effective for periods subsequent to 2013. Management has initially determined the following pronouncements, which the Bank will apply in accordance with their transitional provisions, to be relevant to its financial statements:

- (i) PAS 1 (Amendment), *Financial Statements Presentation - Presentation of Items of Other Comprehensive Income* (effective from July 1, 2012). The amendment requires an entity to group items presented in other comprehensive income into those that, in accordance with other PFRSs: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. The Bank's management expects that this will not affect the presentation of items in other comprehensive income since the Bank's other comprehensive income only includes unrealized fair value gains on available-for-sale (AFS) securities which can be reclassified to profit or loss when specified conditions are met.
- (ii) PAS 19 (Revised), *Employee Benefits* (effective from January 1, 2013). The revision made a number of changes as part of the improvement throughout the standard. The main changes relate to defined benefit plan as follows:
- eliminates the corridor approach under the existing guidance of PAS 19 and requires an entity to recognize all actuarial gains and losses arising in the reporting period;
 - streamlines the presentation of changes in plan assets and liabilities resulting in the disaggregation of changes into three main components of service costs, net interest on net defined benefit obligation or asset, and remeasurement; and,
 - enhances disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The Bank's unrecognized actuarial gain as of December 31, 2012 amounting to P6.5 million will be recognized in the Bank's statement of comprehensive income.

- (iii) **PFRS 1 (Amendment), *Government Loans*. Current PFRS requires entities to measure government loans with below-market interest rates at fair value, with the benefit accounted for as a government grant. Amendment to PFRS 1 requires a first-time adopter to apply this requirement prospectively to government loans existing at the date of transition to PFRS. A first-time adopter may choose to apply these requirements retrospectively to any government loan, if the information needed had been obtained at the time of initially accounting for the loan. The amendment became effective for annual periods beginning on or after January 1, 2013 but is not applicable to the bank.**
- (iv) **PFRS 7 (Amendment), *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2013). The amendment requires qualitative and quantitative disclosures relating to gross and net amounts of recognized financial instruments that are set-off in accordance with PAS 32, *Financial Instruments: Presentation*. The amendment also requires disclosure of information about recognized financial instruments which are subject to enforceable master netting arrangements or similar agreements, even if they are not set-off in the statement of financial position, including those which do not meet some or all of the offsetting**

criteria under PAS 32 and amounts related to a financial collateral. These disclosures will allow financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with recognized financial assets and financial liabilities on the entity's financial position. The Bank has initially assessed that the adoption of the amendment will not have a significant impact on its financial statements.

- (v) PFRS 13 (Amendment), *Fair Value Measurement* (effective from January 1, 2013). This standard aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across PFRS. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. Management is in the process of reviewing its valuation methodologies for conformity with the new requirements and has yet to assess the impact of the new standard on the Bank's financial statements.
- (vi) PFRS 10 (Amendment), *Consolidated Financial Statements*; PAS 27, *Separate Financial Statements* (effective from January 1, 2013). The amendment requires consolidation model founded on the notion of control applicable to all entities (including SPEs). It also provides new definition of control as the power to direct relevant activities, exposure or rights to variable returns and the link between power and exposure. It also requires continuous reassessment of control required. The standards are not applicable to the Bank.
- (vii) PFRS 11, *Joint Arrangements* and PAS 28, *Investments in Associates and Joint Ventures*. (effective from January 1, 2013).

Joint arrangements are either joint operations or joint ventures. A joint operation is a joint arrangement whereby the parties with joint control have rights to the assets and obligations for the liabilities of the arrangement. Those parties are called joint operators. A joint operator recognizes in relation to its interest its assets, liabilities, revenue and expenses and/or its relative shares thereof.

A joint venture is a joint arrangement whereby the parties with joint control have rights to the net assets of the arrangement. Those parties are called joint venturers. A joint venturer recognizes its interest as an investment and shall account for that investment using the equity method in accordance with PAS 28 Investments in Associates and Joint Ventures unless the entity is exempted from applying the equity method as specify in that standard, PFRS 11.

These amendments are not applicable to the Bank.

- (viii) PFRS 12, *Disclosure of Interests in Other Entities*, was amended to establish the information necessary to evaluate the nature of, and risks associated with, interests in other entities and the effects of those interests on the financial position, financial performance and cash flows. The amendment requires disclosure of significant judgements and assumptions, key financial information of group entities and disclosure interest in unconsolidated structured entities. The amendment became effective for annual periods beginning on or after January 1, 2013 but is not applicable to the Bank.
- (ix) PAS 32 (Amendment), *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2014). The

amendment provides guidance to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. It clarifies that a right of set-off is required to be legally enforceable, in the normal course of business. The Bank does not expect this amendment to have a significant impact on its financial statements.

- (x) PFRS 9, *Financial Instruments: Classification and Measurement* (effective from January 1, 2015). This chapter covers the classification and measurement of financial assets and financial liabilities and it deals with two measurement categories for financial assets: amortized cost and fair value. All equity instruments will be measured at fair value while debt instruments will be measured at amortized cost only if the entity is holding it to collect contractual cash flows which represent payment of principal and interest. The accounting for embedded derivatives in host contracts that are financial assets is simplified by removing the requirement to consider whether or not they are closely related, and, in most arrangement, does not require separation from the host contract.

For liabilities, the standard retains most of the PAS 39 requirements which include amortized cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in case where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch.

To date, other chapters of PFRS 9 dealing with impairment methodology and hedge accounting are still being completed.

Further, in November 2011, the IASB tentatively decided to consider making limited modifications to International Financial Reporting Standard 9's financial asset classification model to address certain application issues.

The Bank does not expect to implement and adopt PFRS 9 until its effective date or until all chapters of this new standard have been published. In addition, management is currently assessing the impact of PFRS 9 on the financial statements of the Bank and it plans to conduct a comprehensive study of the potential impact of this standard prior to its mandatory adoption date to assess the impact of all changes.

- (xi) 2009-2011 Annual Improvement to PFRS. Annual improvements to PFRS (2009-2011 Cycle) made minor amendments to a number of PFRS, which are effective for annual period beginning on or after January 1, 2013. Among those improvements, the following amendments are relevant to the Bank but management does not expect a material impact on the Bank's financial statements:

- (a) PAS 1 (Amendment), *Presentation of Financial Statements - Clarification of the Requirements for Comparative Information*.

- Requirements for the opening statement of financial position

If an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period, it shall present such third statement of financial position.

- Requirements for additional comparative information beyond minimum requirements

If an entity presented comparative information in the financial statements beyond the minimum comparative information requirements, the additional financial statements information should be presented in accordance with PFRS including disclosures of comparative information in the related notes for that additional information.

- (b) PAS 16 (Amendment), *Property, Plant and Equipment - Classification of Servicing Equipment*. The amendment addresses a perceived inconsistency in the classification requirements for servicing equipment which resulted in classifying servicing equipment as part of inventory when it is used for more than one period.

- (c) PAS 32 (Amendment), *Financial Instruments - Presentation - Tax Effect of Distribution to Holders of Equity Instruments*. The amendment clarifies that the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with PAS 12.

2.3 Financial Assets

Financial assets are recognized when the Bank becomes a party to the contractual terms of the financial instrument. Financial assets other than those designated and effective as hedging instruments are classified into the following categories: financial assets at fair value through profit or loss (FVTPL), loans and receivables, held-to-maturity (HTM) investments and AFS financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired.

(a) Loans and Receivables

Loans and Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the receivables.

Loans and Receivables are subsequently measured at amortized cost using the effective interest method, less impairment loss, if any. Impairment loss is provided when there is objective evidence that the Bank will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of impairment loss is determined as the difference between the assets' carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate.

The Bank's financial assets categorized as loans and receivables are presented as Cash and Cash Equivalents, Loans and Receivables and Security Deposits in the statement of financial position. Cash and cash equivalents comprise accounts with original maturities of three months or less, including cash and non-restricted balances with BSP and amounts due from other banks. For statement of cash flow purposes, cash and cash equivalents include cash and other cash items, due from BSP and due from other banks.

Loans and receivables also include Securities Purchased Under Reverse Repurchase Agreement (SPURRA) wherein the Bank enters into short-term purchases of securities under reverse repurchase agreements of substantially identical securities with the BSP.

(b) HTM Investments

This category includes non-derivative financial assets with fixed or determinable payments and a fixed date of maturity that the Bank has the positive intention and ability to hold to maturity. If the Bank were to sell other than an insignificant amount of HTM investments, the whole category would be tainted and reclassified as AFS financial assets.

(c) AFS Financial Assets

This category includes non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Bank's AFS financial assets include government securities and proprietary shares.

All financial assets within this category are subsequently measured at fair value. Gains and losses from changes in fair value are recognized in other comprehensive income, net of any income tax effects, and are reported as part of the Revaluation Reserves account in equity.

2.4 Bank Premises, Furniture, Fixtures and Equipment

Land is stated at cost less impairment losses, if any. Bank premises, furniture, fixtures and equipment are carried at acquisition cost less subsequent depreciation, amortization and any impairment losses.

The cost of an asset comprises its purchase price and directly attributable cost of bringing the asset to working condition for its intended use. Expenditures for

additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred.

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

Bank premises	50 years
Office furniture, fixtures and equipment	5 years

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

2.5 Investment Properties

Investment properties include land and building acquired by the Bank from defaulting borrowers which are held either to earn rental income or for capital appreciation or for both, but not held for sale in the next twelve months or used in the rendering of services or for administrative purposes.

Investment properties are stated at cost, less accumulated depreciation and any impairment losses. The cost of an investment property comprises its purchase price and directly attributable costs incurred. For these assets, the cost is recognized initially at the lower of the outstanding loan balance or bid price, which should not be higher than the appraised value of the property.

2.6 Other Resources

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

2.7 Intangible Assets

Intangible assets include acquired branch licenses and software used in operations and administration which are accounted for under the cost model and reported under Other Resources account in the statement of financial position. The cost of the asset is the amount of cash and cash equivalents paid or the fair value of the other considerations given to acquire an asset at the time of its acquisition.

2.8 Financial Liabilities

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

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

2.9 Offsetting Financial Instruments

Financial assets and liabilities are set off and the resulting net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

2.10 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation.

2.11 Revenue and Expense Recognition

Revenue is recognized to the extent that the revenue can be reliably measured; it is probable that the economic benefits will flow to the Bank; or the costs incurred or to be incurred can be measured reliably. In addition, the following specific recognition criteria must also be met before revenue is recognized:

- (a) *Interest income and expense* - are recognized in the profit or loss for all financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

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.

- (b) *Service charges and fees* - are generally recognized on an accrual basis when the service has been provided. Fees arising from negotiating, or participating in the negotiation of, a transaction for a third party - such as the arrangement of the acquisition of debt instruments or other securities - are recognized on completion of the underlying transaction. Other service fees are recognized based on the applicable service contracts, usually on a time-appropriate basis.
- (c) *Gains from assets acquired/exchanged* - are recognized in the profit or loss when the title to the assets is transferred to the buyer or when the collectibility of the entire sales price is reasonably assured.

- (d) *Trading gains* - are recognized when the ownership of the security is transferred to the buyer and is computed as the difference between the selling price and the carrying amount of the security.

Cost and expenses are recognized in the profit or loss upon utilization of the goods or services or at the date these are incurred. All finance costs are reported in profit or loss on an accrual basis.

2.12 Leases

The Bank accounts for its leases as follows:

(a) Bank as Lessee

Leases which transfer to the Bank substantially all risks and benefits incidental to ownership of the leased item are classified as finance leases and are recognized as assets and liabilities in the statement of financial position at amounts equal to the fair value of the leased property at the inception of the lease or, if lower, at the present value of minimum lease payments.

Leases which do not transfer to the Bank substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as expense in profit or loss on a straight - line basis over the lease term. Associated costs, such as repairs and maintenance and insurance, are expensed as incurred.

(b) Bank as Lessor

Leases which do not transfer to the lessee substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized in profit or loss on a straight-line basis over the lease term.

2.13 Impairment of Financial Assets

The Banks assesses at the end of each reporting period whether there is an objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and 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 has an impact of the estimated future cash flows of the financial asset or group of financial assets that can e reliably estimated.

2.14 Impairment of Non-financial Assets

The Bank's premises, furniture, fixtures and equipment, investment properties, intangible assets and other non-financial assets are subject to impairment testing. Intangible assets with an indefinite useful life or those not yet available for use are tested for impairment at least annually. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

2.15 Employee Benefits

The Bank provides post-employment benefits to employees through a defined benefit plan, as well as various defined contribution plans.

(a) Defined Benefit Plan

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, year of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Bank, even if plan assets for funding the defined benefit plan have been acquired.

(b) Defined Contribution Plans

A defined contribution plan is a pension plan under which the Bank pays fixed contributions into an independent entity. Under this plan, the Bank has no legal or constructive obligations to pay further contributions after the payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets maybe recognized if underpayment or prepayment has occurred and are normally of a short-term nature.

(c) Compensated Absences

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. They are included in Other Liabilities account in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement.

2.16 Income Taxes

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

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

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

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in the statement of comprehensive income. Only changes in deferred tax assets or liabilities that relate to items recognized in other comprehensive income or directly in equity.

2.17 Related Party Transactions

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

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

3 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

3.1 Critical Management Judgments in Applying Accounting Policies

(a) Classifying Financial Assets as Held-to-maturity Investments

In classifying non-derivative financial assets or determinable payments and fixed maturity, such as bonds, as HTM investments, the Bank evaluates its intention and ability to hold such investments up to maturity.

(b) Impairment of Available-for-sale Securities

The determination when an investment is other-than-temporarily impaired requires significant judgment. In making this judgment, the Bank evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost, and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

(c) Distinction Between Investment Properties and Owner-occupied Properties

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

(d) Distinction between Operating and Finance Leases

The Bank has entered into various lease agreements as lessee. Critical judgment was exercised by management to distinguish each lease agreement as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements.

3.2 Key Sources of Estimation Uncertainty

(a) Impairment of Loans and Receivables

Adequate amount of allowance is provided for specific and groups of accounts, where objective evidence of impairment exists. The Bank evaluates the amount of allowance for impairment based on available facts and circumstances affecting the collectibility of the accounts, including, but not limited to, the length of the Bank's relationship with the borrowers' current credit status, average age of accounts, value of the collaterals, collection experience and historical loss experience.

(b) Fair Value Measurement for Financial Assets Other than Loans and Receivables

The Bank carries certain financial assets at fair value, which requires the extensive use of accounting estimates and judgment. In cases when active market quotes are not available, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net base of the instrument.

(c) Estimating Useful Lives of Bank Premises, Furniture, Fixtures and Equipment, Investment Properties Except Land, and Computer Software

The Bank estimates the useful lives of bank premises, furniture, fixtures, and equipment, investment properties, and computer software based on the period over which the assets are expected to be available for use.

The estimated useful lives of those assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

(d) Fair Value Measurement of Investment Property

The Bank's investment properties are composed of parcels of land and buildings acquired from defaulting borrowers not held for sale in the next twelve months. The estimated fair values of these assets, are determined by in-house and independent appraisers. The fair value is determined by reference to market-based evidence, which is the amount for which the assets could be exchanged between a knowledgeable willing buyer and seller in an arm's length transaction as at the valuation date.

(e) Determining Realizable Amount of Deferred Tax Assets

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

(f) Impairment of Non-financial Assets

Except for intangible assets with indefinite useful lives, PFRS requires that an impairment review be performed when certain impairment indications are present. In assessing impairment, management estimates the recoverable amount of each asset or cash-generating unit based on expected future cash flows and uses an interest rate to calculate the present value of those cash flows.

(g) Valuation of Post-employment Defined Benefit

The determination of the amounts of post-employment benefit obligation is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, discount rates, expected rate of return on plan assets, expected rate of salary increases, and employee turnover rate.

4 RISK MANAGEMENT OBJECTIVES AND POLICIES

The Bank's Risk Management Committee (RMC) has overall responsibility for the Bank's risk management systems and sets risks management policies across the full range of risks to which the Bank is exposed. The Bank's RMC places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions.

4.1 Credit Risk

Credit risk is the risk that the counterpart in a transaction may default and arises from lending, treasury, and other activities undertaken by the Bank. The Bank manages its credit risk and loan portfolio through the Accounts Management Department (AMD), which undertakes several functions with respect to credit risk management.

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

4.2 Liquidity Risk

Liquidity risk is the risk that there are insufficient funds available to adequately meet the credit demands of the Bank's customers and repay deposits on maturity. The Bank manages liquidity risk by holding sufficient liquid assets of appropriate quality to ensure short-term funding requirements are met.

4.3 Interest Rate Risk

The Bank's policy is to minimize interest rate cash flow risk exposures. The Bank's cash flow interest rate risk relates primarily to the possible changes in the prevailing interest rates of due from other banks, SPURRA and floating rate loans. The volatility in the interest rates of these financial instruments will result to an increase or decrease of the Bank's interest spread, and consequently will affect its financial performance.

5 DUE FROM BANGKO SENTRAL NG PILIPINAS (BSP)

As of June 30, 2013 and December 31, 2012, the Bank has deposits considered as mandatory reserves with the BSP totaling P451.1 million and P225.9 million, respectively.

Mandatory reserves represent the balance of the deposit account maintained with BSP to meet reserve requirements on deposit liabilities for thrift banks.

6 DUE FROM OTHER BANKS

This account represents deposits with local banks which are composed of the following:

	<u>2013</u>	<u>2012</u>
Savings	32,572,468	39,826,420
Time	76,001,887	73,063,776
	<u>108,574,354</u>	<u>112,890,196</u>

Savings accounts represent clearing and other depository accounts with other banks.

Time includes special savings deposits and have average maturities of one month.

7 AVAILABLE-FOR-SALE SECURITIES

The breakdown of AFS securities as to type of instrument is shown below:

	<u>2013</u>	<u>2012</u>
Government debt securities:		
Unquoted	48,000,000	50,000,000
Quoted	34,093,374	33,945,957
Proprietary club shares - quoted	16,570,000	18,080,000
	<u>98,663,374</u>	<u>102,025,957</u>

Quoted government debt securities include debt securities issued by the Republic of the Philippines.

These securities will mature in various dates withing 2014 to 2037.

Unquoted debt securities amounting to P48 million is issued by the local government of Infanta, which is carried at cost as the fair value of such security cannot be determined.

Proprietary club shares consist of golf shares of Forest Hills Golf & Country Club, previously acquired from borrowers as settlement of loan, and of Wack Wack Golf & Country Club. The golf shares have been designated by the Bank as AFS securities as these shares are being held indefinitely.

8 LOANS AND RECEIVABLES

The details of this account follow:

	<u>2013</u>	<u>2012</u>
Receivables from customers	1,665,681,745.64	1,658,365,143
SPURRA	-	294,000,000
Sales contract receivables	28,491,867	34,196,853
Other receivables	86,727,420	69,318,842
	1,780,901,033	2,055,880,838
Unearned interests, discounts and other charges	(18,762,137)	(25,844,330)
Allowance for impairment	(29,802,617)	(29,802,617)
	1,732,336,279	2,000,233,891

9 BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT

	Land	Bank Premises	Office Furniture, Fixtures and Equipment	Leasehold Improve- ments	Total
June 30, 2013					
Cost	85,003,485	120,396,191	104,581,906	17,712,963	327,694,544.39
Accumulated depreciation and amortization	-	(34,697,484)	(89,769,653)	(10,780,731)	(135,247,868.39)
Net Carrying Amount	85,003,485	85,698,707	14,812,253	6,932,231	192,446,676.00
December 31, 2012					
Cost	P 85,003,485	P 120,298,796	P 99,911,979	P 15,958,288	321,172,548.00
Accumulated depreciation and amortization	-	(32,527,964)	(88,436,567)	(11,176,421)	(132,140,952.00)
Net Carrying Amount	P 85,003,485	P 87,770,832	P 11,475,412	P 4,781,867	189,031,596.00
January 1, 2012					
Cost	P 85,003,485	P 119,258,807	P 91,592,311	P 21,242,593	317,097,196.00
Accumulated depreciation and amortization	-	(28,292,968)	(83,627,304)	(18,196,777)	(130,117,049.00)
Net Carrying Amount	P 85,003,485	P 90,965,839	P 7,965,007	P 3,045,816	186,980,147.00

Depreciation and amortization expenses amounting to P7.13 million in 2013 and P6.86 million in 2012 are shown as part of the Depreciation and Amortization account in the statements of Comprehensive Income.

The BSP requires that investments in fixed assets do not exceed 50% of the Bank's unimpaired capital. As of June 30, 2013, the Bank has satisfactorily complied with this BSP requirement.

10 INVESTMENT PROPERTIES

The gross carrying amounts and accumulated depreciation and impairment of investment properties at the beginning and end of 2013 and 2012 are shown below.

		Land		Building		Total
June 30, 2013						
Cost	P	21,259,595	P	25,572,080	P	46,831,674
Accumulated depreciation				(6,313,607)		(6,313,607)
Allowance for impairment		(550,090)				(550,090)
Net Carrying Amount	P	20,709,505	P	19,258,472	P	39,967,977
December 31, 2012						
Cost	P	18,877,674	P	21,607,723	P	40,485,397
Accumulated depreciation		-		(4,969,614)		(4,969,614)
Allowance for impairment		(550,089)		-		(550,089)
Net Carrying Amount	P	18,327,585	P	16,638,109	P	34,965,694
January 1, 2012						
Cost	P	23,638,008	P	18,358,950	P	41,996,958
Accumulated depreciation		-		(3,821,981)		(3,821,981)
Allowance for impairment		(550,089)		-		(550,089)
Net Carrying Amount	P	23,087,919	P	14,536,969	P	37,624,888

Income earned by the Bank from its investment properties leased to third parties under operating lease agreements amounted to P1.13 million and P1.33 million in 2013 and 2012, respectively, and is recorded as part of Rental Income under Miscellaneous Income account in the statements of comprehensive income.

11 OTHER RESOURCES

The details of this account follow:

	<u>2013</u>	<u>2012</u>
Branch licenses	32,500,000	32,500,000
Non-financial assets - net	20,664,354	11,223,512
Deferred tax assets - net	13,661,733	13,661,733
Sundry debits	11,927,256	11,987,633
Prepaid expenses	10,467,581	4,547,959
Security deposits	6,288,964	6,213,479
Stationery and supplies on hand	5,748,076	4,710,779
Advance rental	2,598,821	2,673,284
Deposit with Philippine Clearing House Corp (PCHC)	2,500,000	2,500,000
Computer software - net	2,402,439	1,686,487
Building under construction	550,000	-
Returned checks	536,704	12,438,161
Bancnet	500,000	500,000
Advances to suppliers	4,627,870	469,034
Utility deposit	404,460	404,460
Documentary stamps	379,704	410,960
Other investments	153,333	153,333
Miscellaneous	5,179,473	3,450,138
	<u>121,090,767</u>	<u>109,530,952</u>

Branch licenses pertain to the cost of the licenses the Bank acquired in 2004 and in 2006 for a consideration of P11.0 million and P20.0 million respectively. The Bank also incurred P1.5 million representing relocation costs of the branches acquired in 2004.

Non-financial assets include foreclosed vehicles and jewelry items formerly classified as real and other properties acquired (ROPA) .As per BSP classification, ROPA which are neither held for capital appreciation, leased out or used in operation, shall be classified as other non-financial asset, accounted for using cost model, subject to periodic depreciaiton and annual impairment testing.

Sundry debits and sundry credits mainly pertain to automated teller machine deposit and withdrawal transactions, including fees and charges thereon, which are yet to be classified, cleared and applied against proper customers' accounts within one month from date of entry.

Security deposits include refundable and non-refundable deposits for the lease of the various Bank branches from several parties. Refundable security deposits are remeasured at amortized cost using the effective interest rates ranging from 5.76% to 7.42% at the inception of the lease contracts. The fair values on initial recognition of the security deposits were determined by calculating the present value of the future cash flows anticipated until the end of the lease term using discount rates determined by reference to market interest rate of comparable financial instrument.

Computer software pertains to the cost of system software and other expenditures related to software upgrade which is amortized by the Bank over a period of five to ten years. Amortization of computer software amounted to P304,403 in 2013 and P581,271 in 2012 and are included as part of Other Expenses in the statements of comprehensive income.

12 DEPOSIT LIABILITIES

The breakdown of deposit liabilities as to currency is shown below.

	<u>2013</u>	<u>2012</u>
Philippine Peso	1,906,846,226	2,047,266,367
US Dollars	74,133,918	1,768,495
	<u>1,980,980,145</u>	<u>2,049,034,862</u>

The Bank's deposit liabilities as of June 30, 2013 and December 31, 2012 have maturities of less than one year.

13 OTHER LIABILITIES

The balance of this account consists of the following:

	<u>2012</u>	<u>2011</u>
Accounts payable	25,377,283	12,432,132
Accrued expenses	18,769,761	13,726,216
Cashier's and manager's checks	4,879,815	21,440,058
Sundry credits	405,074	3,240,480
Bills payable - BSP	114,675	-
Income tax payable	-	3,472,367
Security deposits	1,463,071	751,949
Bills purchased clearing	333,104	512,295
Post employment benefit obligation	-	2,431,168
Miscellaneous	72,089	50,167
	<u>51,414,873</u>	<u>58,056,832</u>

Accrued expenses are mainly composed of gross receipt taxes, insurance premium accrual for PDIC, and various accruals for utilities, security and janitorial services.

Accounts payable, on the other hand, is mainly composed of collections of SSS contributions from various Bank clients which are remitted to SSS in the succeeding month following the month of collections, advanced collections from borrowers and payable to third party vendors for purchases of goods and services.

Security deposits pertain to the deposits received from third parties related to the lease of Bank-owned investment properties, refundable at the end of the lease terms. The security deposits are remeasured at amortized cost using the effective interest method.

14 EQUITY

14.1 Capital Stock

As of June 30, 2013 and December 31, 2012, the Bank has total authorized capital stock of 100,000,000 common shares at P10 par value per share. As of those dates, total issued and outstanding shares consist of 72,764,998 shares amounting to P727.6 million.

14.2 Retained Earnings

On September 30, 2010, the Bank paid cash dividends amounting to P2.2 million. Such dividends were approved for declaration by the Bank's BOD on May 26, 2009 and by the BSP on July 28, 2010.

14.3 Capital Management and Regulatory Capital

Under current banking regulations, the combined capital accounts of the Bank should not be less than an amount equal to 10% of its risk assets. The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio is total equity excluding:

- (a) unbooked valuation reserves and other capital adjustments as may be required by the BSP;
- (b) total outstanding unsecured credit accommodations to directors, officers, stockholders and related interest;
- (c) deferred tax asset or liability;
- (d) goodwill;
- (e) accumulated equity in earnings of investee where the Bank holds 50% or less but where the equity method of accounting has been applied; and
- (f) appraisal increment on bank premises, furniture, fixtures and equipment other than those allowed to be recognized in connection with a merger or acquisition.

Risk assets consist of total assets after exclusion of cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits, and other non-risk items as determined by the Monetary Board of the BSP.

The amount of surplus funds available for dividend declaration is determined also on the basis of regulatory networth after considering certain adjustments.

The Bank's policy is to maintain a strong capital base as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholder's return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

14.4 Minimum Capital Requirement

Under an existing BSP circular, thrift banks are required to comply with the minimum capital requirements amounting to P400.0 million.

As of June 30, 2013, the Bank has complied with the above capitalization requirement.

15 MISCELLANEOUS INCOME AND OTHER OPERATING EXPENSES

Presented below are the details of these accounts:

15.1 Miscellaneous Income

	<u>2013</u>	<u>2012</u>
Penalty on Loans	1,399,464	778,715
Income or loss - Trust dept	871,225	424,417
Income on assets acquired	-	7,142,254
Trading Gain	-	98,641
Others	6,273,604	6,044,060
	<u>8,544,292</u>	<u>14,488,086</u>

15.2 Other Expenses

	2013	2012
Stationery and supplies used	1,824,385	1,215,237
Representation and entertainment	1,553,905	2,649,400
Management & other professional fees	1,327,504	860,237
Advertising and publicity	575,863	1,310,603
Travelling expenses	667,984	483,309
Amortization of computer software	304,404	581,271
Banking fees	381,220	401,688
Commission fees	156,388	-
Provision for year-end expenses	-	-
Membership fees and dues	64,409	54,514
Freight fees	41,434	28,493
Information technology	31,163	115,812
Periodicals and magazines	43,826	14,333
Others	4,565,758	2,836,728
	11,538,242	10,551,625

16 TAXES

16.1 Gross Receipts Tax (GRT)

On January 29, 2004, Republic Act 9238 reverted the imposition of GRT on banks and financial institutions. This law is retroactive from January 1, 2004. Further, on May 24, 2005, the amendments on RA No. 9337 was approved imposing the following rates to be collected on gross receipts derived from sources in the Philippines by all banks and non-bank financial intermediaries:

- (a) On interest, commissions and discounts from lending activities as well as income from financial leasing, on the basis of remaining maturities of instruments from which such receipts are derived:

With maturity period of five years or less	5%
With maturity period of more than five years	1%

- (b) On dividends and equity shares in the net income of subsidiaries 0%

- (c) On royalties, rentals of property, real or personal, profits from exchange and all other items treated as gross income under Section 32 of the National Internal Revenue Code 7%

- (d) On net trading within the taxable year on foreign currency, debt securities, derivatives, and other similar financial instruments 7%

Provided, however, that in case the maturity period referred to in paragraph (a) is shortened thru pretermination, then the maturity period shall be reckoned to end as of the date of pretermination for purposes of classifying the transaction and the correct rate of tax shall be applied accordingly.

16.2 Documentary Stamp Tax (DST)

DST at rates ranging from P0.30 to P2 on each P200 of the face value of the certificate or document are imposed on the following:

- (a) Bank checks, drafts, or certificate of deposit not bearing interest, and other instruments;
- (b) Bonds, loan agreements, promisory notes, bills of exchange, drafts, instruments and securities issued by the Government or any of its instrumentalities, deposit substitute debt instruments, certificates of deposits bearing interest and other not payable on sight or demand;
- (c) Acceptance of bills of exchange and letters of credit; and,
- (d) Bills of lading or receipt

On February 7, 2004, RA 9243 was passed amending the rates of DST, the significant provisions of which are summarized below:

- (a) On every issue of debt instruments, there shall be collected DST of P1 on each P200 or fractional part of the issue price of any such debt instrument;
- (b) On all sales or transfer of shares or certificates of stock in any corporation, there shall be collected a DST of P0.75 on each P200, or fractional part, of the par value of such stock;
- (c) On all bills of exchange or drafts, there shall be collected DST of P0.30 on each P200, or fractional part, of the face value of any such bill of exchange or draft; and,
- (d) The following instruments, documents and papers shall be exempt from DST:

Borrowings and lending of securities executed under the Securities Borrowing and Lending Program of a registered exchange, or in accordance with regulations prescribed by the appropriate regulatory authority;

Loan agreements or promisory notes, the aggregate of which do not exceed P250 thousand or any such amount as may be determined by the Secretary of Finance, executed by an individual for his purchase on installment for his personal use;

Sale, barter or exchange of shares of stock listed and traded through the local stock exchange for a period of five years from the effectivity of RA 9243;

Fixed income and other securities traded in the secondary market or through an exchange;

Derivatives including repurchase agreements and reverse repurchase agreements;

Bank deposit accounts without a fixed term or maturity; and,

Interbank call loans with maturity of not more than seven days to cover deficiency in reserve against deposit liabilities.

17 RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank enters into varying transactions with its related parties, certain directors, officers, stockholders, and related interests (DOSRI), and with its funded retirement plan.

17.1 Loans to Related Parties

Under existing policies of the Bank, these loans are made on substantially the same terms as loans granted to other individuals and businesses of comparable risks. The General Banking Act and BSP regulations limit the amount of the loans granted by a bank to a single borrower to 25% of equity. The amount of individual loans to DOSRI, of which 70% must be secured, should not exceed the amount of the unencumbered deposit and book value of the investment in the Bank. In the aggregate, loans to DOSRI generally should not exceed the total equity or 15% of the total loan portfolio of the Bank, whichever is lower.

17.2 Transactions with the Retirement Plan

The Bank's retirement fund for its defined benefit post-employment plan maintained for qualified employees, is administered and managed by the Bank's Trust Department under a trust agreement.

Equity securities of the retirement fund consist of investments in corporations listed in the PSE, which include P8.5 million investments in the shares of stock of the Bank; while debt securities is composed of investments in corporate bonds.

17.3 Lease Transactions

The Bank, as a lessee, has lease agreements with related parties under common ownership. In relation to these lease agreements, the Bank made certain security deposits totaling P6.3 million and P6.2 million as of June 30, 2013 and December 31, 2012, respectively, and are presented as part of Other Resources account in the statements of financial position. Rent expense arising from these leases are presented as part of Occupancy in the statements of comprehensive income.

18 COMMITMENTS AND CONTINGENCIES

18.1 Operating Lease Commitments - Bank as Lessee

The Bank leases the premises where some of its branches and extension offices are situated for a period of one to ten years, renewable upon mutual agreement between the parties and with terms of one to seven years. These leases are accounted for as operating leases which either require fixed rental rate over the term of the lease or with stipulated annual escalation rate of 5% to 10%.

The Bank's total rent expense (shown as Occupancy account in the statements of comprehensive income) amounted to P13.40 million in 2013 and P13.34 million in 2012.

18.2 Operating Lease Commitments - Bank as Lessor

The Bank is a lessor under non-cancellable operating lease agreements for the lease of its investment property. The leases have terms of five to ten years, with renewal options, and include annual escalation rate of 5% to 10%.

The total rent income on investment properties amounted to P1.13 million and P1.33 million in 2013 and 2012, respectively and is presented as Rental income under Miscellaneous Income account in the statements of comprehensive income.

18.3 Others

In the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities such as guarantees and commitments to extend credit, which are not reflected in the financial statements. Management believes that, as of June 30, 2013, losses, if any, that may arise from these commitments and contingent liabilities will not have a material effect on the Bank's financial statements.

Following is a summary of the Bank's commitments and contingent accounts as of June 30, 2013 and December 31, 2012.

	2013	2012
Trust department accounts	251,204,045	256,959,031
Deficiency claims receivable	1,434,382	1,434,382
Items held as collateral	25,789	22,187
Late deposits/payment received	913,909	1,272,127
Items held for safekeeping	4,728	5,617
Outward bills for collection	660	6,367

19 OTHER THAN WHAT WERE REPORTED OR DISCLOSED IN THE ACCOMPANYING FINANCIAL STATEMENTS, THERE ARE NO -

- a) Material transactions that had an effect on the assets, liabilities, equity, net income, cash flows which are of unusual nature or size brought about by seasonal events or cyclical events.
- b) Changes in estimates of amounts reported in prior interim periods of prior financial years that have material effect in the current interim period.
- c) There are no known material commitments for capital expenditures as of reporting date.
- d) Issuances, repurchases, and repayments of equity securities
- e) Segment revenue and segment result for business segments or geographical segments.
- f) Material events subsequent to the end of the interim period that have not been reflected in the financial statements for the interim period.
- g) Material contingencies and any other events or transactions that are material to an understanding of the current interim period.
- h) Events that will trigger direct or contingent financial obligations that is material to the company including any default or acceleration of an obligation.
- i) Material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the company with unconsolidated entities or other persons created during the reporting period.

CITYSTATE SAVINGS BANK
AGING OF ACCOUNTS RECEIVABLE
As of June 30, 2013

Accountee	Below 60 days	61 to 180 days (Substandard)	181 to 360 days (Doubtful)	361 days or more (Loss)	TOTAL
HEAD OFFICE	2,616,982.35	1,844,383.64	1,368,000.84	4,370,786.08	10,200,152.91
CHINO ROCES BRANCH	47,668.02	55,583.50	199,719.39	25,259.91	328,230.82
BINONDO BRANCH	-	-	-	-	-
PANADEROS BRANCH	-	-	-	-	-
PACO BRANCH	5,000.00	-	-	-	5,000.00
GUADALUPE BRANCH	-	-	-	-	-
MABINI BRANCH	4,540.86	-	-	-	4,540.86
BACLARAN BRANCH	-	-	-	-	-
PASAY BRANCH	3,000.00	-	-	-	3,000.00
SHAW BRANCH	1,040.84	-	-	-	1,040.84
CUBAO	-	-	-	-	-
MUNTINLUPA	-	-	-	-	-
CALOOCAN	-	-	-	-	-
MARIKINA	8,000.40	-	-	-	8,000.40
BLUMENTRITT	15,000.00	-	-	-	15,000.00
LAS PIÑAS	-	5,759.50	-	-	5,759.50
GREENHILLS	-	-	-	-	-
PASAY ROAD	-	-	-	-	-
ANTIPOLO	5,554.64	-	-	-	5,554.64
KATIPUNAN	5,000.00	-	-	-	5,000.00
TAGUIG	-	-	-	-	-
DAGUPAN	2,040.00	-	-	-	2,040.00
BALIUAG BRANCH	-	-	-	-	-
MEYCAUYAN BRANCH	-	-	-	-	-
PLARIDEL	-	-	-	-	-
CEBU BRANCH	3,000.00	32,400.00	-	-	35,400.00
TOTAL	2,716,827.11	1,938,126.64	1,567,720.23	4,396,045.99	10,618,719.97