Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines

CORPORATE GOVERNMENT SECTOR
Cluster I – Banking and Credit

August 26, 2020

THE BOARD OF DIRECTORS
UCPB Leasing and Finance Corporation
UCPB Corporate Office
Makati Avenue, Makati City

Gentlemen:

Pursuant to Section 2, Article IX-D of the Philippine Constitution and Section 43 of Presidential Decree No. 1445, otherwise known as the Government Auditing Code of the Philippines, we transmit herewith our report on the results of audit of the accounts and transactions of **UCPB Leasing and Finance Corporation (ULFC)** for the year ended December 31, 2019.

The report consists of the Independent Auditor's Report, Audited Financial Statements, and the Observations and Recommendations.

The Auditor rendered an unmodified opinion on the fairness of presentation of the financial statements of the ULFC for the year ended December 31, 2019.

In a letter of even date, we requested the Officer-in-Charge of ULFC that the recommendations contained in Part II of the report be implemented and that this Commission be informed of the actions taken thereon by submitting the Agency Action Plan and Status of Implementation (copy attached) within 60 days from date of receipt.

We acknowledge the support and cooperation that Management extended to the Audit Team, thus, facilitating the completion of the report.

Very truly yours,

COMMISSION ON AUDIT

By:

ADELA L. DONDONILLA
Director IV
Cluster Director

Copy furnished:

The President of the Philippines
The Vice President
The President of the Senate
The Speaker of the House of Representatives
The Chairperson – Senate Finance Committee
The Chairperson – Appropriations Committee
The Secretary of the Department of Budget and Management
The Governance Commission of Government-Owned or Controlled Corporation
The National Library
The UP Law Center

RECEIVED BY:
UNITED COCONUT PLANTERS BANK
AUG 28 2020
OFFICE OF THE CORPORATE SECRETARY

Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines

CORPORATE GOVERNMENT SECTOR
Cluster I – Banking and Credit

August 26, 2020

UCPB LEASING AND FINANCE CORP.
OFFICE OF THE PRESIDENT
AUG 28 2020
RECEIVED BY:
MAUREEN D. CAYABYAB

Ms. MERCY K. CHUA
Officer-in-Charge
UCPB Leasing and Finance Corporation
UCPB Corporate Office
Makati Avenue, Makati City

Dear Ms. Chua:

Pursuant to Section 2, Article IX-D of the Philippine Constitution and Section 43 of Presidential Decree No. 1445, otherwise known as the Government Auditing Code of the Philippines, we transmit herewith our report on the results of audit of the accounts and transactions of **UCPB Leasing and Finance Corporation (ULFC)** for the year ended December 31, 2019.

The report consists of the Independent Auditor's Report, Audited Financial Statements, and the Observations and Recommendations.

The Auditor rendered an unmodified opinion on the fairness of presentation of the financial statements of the ULFC for the year ended December 31, 2019.

We respectfully request that the recommendations contained in Part II of the report be implemented and that this Commission be informed of the actions taken thereon by submitting the Agency Action Plan and Status of Implementation Form (copy attached) within 60 days from the date of receipt.

We acknowledge the support and cooperation that Management extended to the Audit Team, thus, facilitating the completion of the report.

Very truly yours,

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By:

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Director IV
Cluster Director

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Republic of the Philippines

COMMISSION ON AUDIT

Commonwealth Ave., Quezon City

ANNUAL AUDIT REPORT

on the

UCPB LEASING AND FINANCE CORPORATION

For the year ended December 31, 2019

EXECUTIVE SUMMARY

INTRODUCTION

UCPB Leasing and Finance Corporation (ULFC or the Company) is a domestic corporation incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) under SEC Registration No. AS00158561 on January 2, 1989 as a finance company under Republic Act No. 8556, The Financing Company Act of 1998, (the Financing Company Act). The Company is presently engaged in providing services such as lease financing, check discounting and trade receivable financing.

The Company is a wholly owned subsidiary of United Coconut Planters Bank (UCPB or the Parent Bank), a universal bank incorporated and domiciled in the Philippines organized to provide expanded commercial banking services such as deposit products, loans and trade finance, domestic and foreign fund transfers, treasury, foreign exchange investment banking and trust services.

As of December 31, 2019 and 2018, the Company holds 100 per cent ownership interest in United Foreign Exchange Corporation (UFEC), a domestic company primarily engaged in dealing of foreign currencies and financial instruments.

In September 2010, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP) approved the Company's application to engage in quasi-banking functions. In January 2012, however, the Company decided to cancel its quasi-banking license and the BSP approved its immediate revocation on April 26, 2012.

The powers and functions of the ULFC are exercised by the Board of Directors composed of seven directors and stockholders of the Company. The Board is headed by a Chairman who is the President and Chief Executive Officer of the UCPB.

On August 18, 2017, the SEC approved the change in the registered principal office of the Company from 14th Floor, UCPB Building, 7907 Makati Avenue, Makati City to 6th Floor, UCPB Corporate Offices, 7907 Makati Avenue, Makati City. On August 20, 2018, the Bureau of Internal Revenue approved such change in the registered principal office.

As at December 31, 2019, the Company had a total manpower of 50 consisting of 26 officers and 24 non-officers, which is headed by the Officer-in-Charge.

SCOPE AND OBJECTIVES OF AUDIT

The audit covered the examination, on a test basis, of transactions and accounts of ULFC for the period January 1 to December 31, 2019 in accordance with the International Standards of Supreme Audit Institutions to enable us to express an opinion on the fairness of presentation of the financial statements for the year ended December 31, 2019. Also, we conducted our audit to assess compliance with pertinent laws, rules and regulations, as well as adherence to prescribed policies and procedures.

FINANCIAL HIGHLIGHTS (In Philippine Peso)

I. Comparative Financial Position

Particulars	2019	2018	Increase
Assets	3,201,017,173	3,071,803,470	129,213,703
Liabilities	1,787,120,988	1,703,079,017	84,041,971
Equity	1,413,896,185	1,368,724,453	45,171,732

II. Comparative Results of Operations

Particulars	2019	2018	Increase (Decrease)
Revenues	271,360,817	265,627,064	5,733,753
Interest expense	81,161,331	71,575,811	9,585,520
Operating expenses	119,090,693	193,047,735	(73,957,042)
Net income/(loss) before tax	**71,108,793**	**1,003,518**	**70,105,275**
Tax income/(expense)	28,402,240	(19,334,085)	47,736,325
Net profit/(loss)	**42,706,553**	**20,337,603**	**22,368,950**
Other comprehensive income/(loss)	138,000	(427,500)	565,500
Total comprehensive income	**42,844,553**	**19,910,103**	**22,934,450**

III. Comparative Budget and Actual Expenditures

	2019		2018	
	Approved Budget	**Expenditures**	**Approved Budget**	**Expenditures**
Personal services	59,022,496	39,710,379	50,492,476	48,717,708
Operating expenses	83,549,614	62,777,431	80,272,875	68,767,104
Total	142,572,110	102,487,810	130,765,351	117,484,812

AUDITOR'S OPINION

The Auditor rendered an unmodified opinion on the fairness of the presentation of the financial statements of the ULFC as at December 31, 2019.

SIGNIFICANT AUDIT OBSERVATIONS AND RECOMMENDATIONS

1. The ULFC reported P472.937 million or 15.77 per cent past due loans and receivables which is beyond the approved past due target of 12 per cent for CY 2019 and may impact on the fund support of programs, activities and projects of the Company.

We recommended that Management strictly implement its strategies and action plans to intensify collection efforts in order to improve its credit quality.

2. Unserviceable properties with a total cost of P263,862, recognized under the Other Assets account, were not disposed contrary to Section 79 of Presidential Decree No. 1445. Also, properties totaling P0.769 million were not accounted as at year-end.

We recommended that ULFC:

a. Dispose the unserviceable assets then, de-recognize these from the books;

b. Establish accountability for the unaccounted assets and determine the proper classification of the unclassified assets; and

c. Establish policies and guidelines on the disposal of unserviceable assets and consider the inclusion of a specific timeline for regular disposal to prevent the accumulation of properties no longer needed.

3. The Company's Operations Manual on Loan Loss Estimation Methodology and Allowance for Credit Losses (ACL) is not in accordance with BSP Circular No. 1011 Series of 2018.

We recommended that Management update the Company's Operations Manual on Loan Loss Estimation Methodology and ACL to comply with Philippine Financial Reporting Standard 9 and BSP Circular No. 1011 Series of 2018.

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PART I – AUDITED FINANCIAL STATEMENTS

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

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
UCPB Leasing and Finance Corporation
Makati City

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of **UCPB Leasing and Finance Corporation (ULFC)** which comprise the statement of financial position as at December 31, 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the ULFC as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). 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 are independent of the ULFC in accordance with the ethical requirements that are relevant to our audit of the financial statements in the Philippine Public Sector, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the ULFC for the years ended December 31, 2018 and 2017 were audited by other auditors who expressed an unmodified opinion on those statements in their report dated August 22, 2019.

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 PFRSs, 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 ULFC'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 ULFC or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the ULFC'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 ISSAIs 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 ISSAI, 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 ULFC's internal control.

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

- 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.

Report on Other Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information in Note 23 and Note 24 to the financial statements are presented for purposes of filing with the Bureau of Internal Revenue, and complying with the Revised Securities Regulation Code Rule 68 issued by the Securities and Exchange Commission and the Bangko Sentral ng Pilipinas Circular No. 1075, respectively, and is not a required part of the basic financial statements. Such supplementary information is the responsibility of management and has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

COMMISSION ON AUDIT

ROSALINDA T. SILAGAN
OIC, Supervising Auditor

July 30, 2020

6th Floor, UCPB Corporate Offices
7907 Makati Avenue, Makati City
Philippines 0728

tel: (632) 811-9000
fax: (632) 811-9613
e-mail: crc@ucpb.com
web: www.ucpb.com

UCPB LEASING & FINANCE

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of **UCPB LEASING AND FINANCE CORPORATION** (the Company) is responsible for the preparation and fair presentation of the financial statements, including the schedules attached therein, as of and for the years ended December 31, 2019 and 2018, in accordance with the prescribed financial reporting framework indicated therein, 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 Company'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 Company or to cease operations, or has no realistic alternative to do so.

The Board of Directors is responsible for overseeing the Company's financial reporting process.

The Board of Directors reviews and approves the financial statements, including the schedules attached therein, and submits the same to the stockholders.

Commission on Audit has audited the financial statements of the Company in accordance with Philippine Standards on Auditing, and in their report to the stockholders, have expressed their opinion on the fairness of presentation upon completion of such audit.

LIDUVINO S. GERON
Chairman of the Board

MERCY K. CHUA
Officer-in-charge

IRMA E. JAPSON
Treasurer

Signed this 30 day of July

UCPB Leasing and Finance Corporation
(A wholly owned subsidiary of United Coconut Planters Bank)
STATEMENTS OF FINANCIAL POSITION
December 31, 2019 and 2018
(Amounts in Philippine Peso)

	Note	2019	2018
ASSETS			
Cash and cash equivalents	7	133,496,507	93,683,945
Loans and Receivables, net	8	2,775,689,688	2,681,630,440
Investment in a Subsidiary, net	9	5,687,456	5,380,928
Investment Properties	10	79,896,222	83,890,710
Deferred Tax Assets, net	19	129,423,212	153,078,515
Property and equipment, net	11	26,354,712	12,242,434
Other assets, net	12	50,469,376	41,896,498
TOTAL ASSETS		**3,201,017,173**	**3,071,803,470**
LIABILITIES AND EQUITY			
Bills payable	13, 22	1,227,083,333	1,114,166,667
Accounts payables and other liabilities	14	285,017,914	325,166,897
Deposit on lease contracts	8	275,019,741	263,745,453
TOTAL LIABILITIES		**1,787,120,988**	**1,703,079,017**
Capital Stock	16.2	775,000,000	775,000,000
Revaluation Reserves	9	201,000	63,000
Retained Earnings	16.3	638,695,185	593,661,453
EQUITY		**1,413,896,185**	**1,368,724,453**
TOTAL LIABILITIES AND EQUITY		**3,201,017,173**	**3,071,803,470**

The Notes on pages 10 to 61 form part of these financial statements

UCPB Leasing and Finance Corporation
(A wholly owned subsidiary of United Coconut Planters Bank)
STATEMENTS OF INCOME
For the years ended December 31, 2019 and 2018
(Amounts in Philippine Peso)

	Note	2019	2018
REVENUES			
Interest income	8	159,895,836	166,407,686
Leasing income	8	89,758,127	75,730,573
Equity share in net earnings of a subsidiary	9	168,528	167,204
		249,822,491	242,305,463
Interest Expense	13	(81,161,331)	(71,575,811)
Net interest and leasing income		**168,661,160**	**170,729,652**
Other income, net	17.1	21,538,326	23,321,601
Other operating expenses	17.2	(119,090,693)	(193,047,735)
Profit before tax		**71,108,793**	**1,003,518**
Tax (expense)/income	19	(28,402,240)	19,334,085
Net profit		**42,706,553**	**20,337,603**

The Notes on pages 10 to 61 form part of these financial statements

UCPB Leasing and Finance Corporation
(A wholly owned subsidiary of United Coconut Planters Bank)
STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31, 2019 and 2018
(Amounts in Philippine Peso)

	Note	2019	2018
NET INCOME		**42,706,553**	**20,337,603**
Other comprehensive income/(loss)	9	138,000	(427,500)
TOTAL COMPREHENSIVE INCOME		**42,844,553**	**19,910,103**

Notes on pages 10 to 61 form part of these financial statements

UCPB Leasing and Finance Corporation
(A wholly owned subsidiary of United Coconut Planters Bank)
STATEMENTS OF CHANGES IN EQUITY
For the years ended December 31, 2019 and 2018
(Amounts in Philippine Peso)

			Retained earnings			
	Capital Stock	**Revaluation Reserves**	**Retained earnings - Appropriated**	**Retained earnings - Unapropriated**	**Total Retained earnings**	**TOTAL**
	Note 16.2	Note 9		Note 16.3		
Balance at January 1, 2019	**775,000,000**	**63,000**	**219,601,433**	**374,060,020**	**593,661,453**	**1,368,724,453**
Prior period adjustment				2,327,179	2,327,179	2,327,179
General loan loss provisioning appropriation for the year			2,678,539	(2,678,539)		0
Total comprehensive income for the year		138,000		42,706,553	42,706,553	42,844,553
Balance at December 31, 2019	**775,000,000**	**201,000**	**222,279,972**	**416,415,213**	**638,695,185**	**1,413,896,185**
Balance at January 1, 2018						
As previously reported	**775,000,000**	**490,500**	**200,000,000**	**626,501,193**	**826,501,193**	**1,601,991,693**
Effect of adoptation of PFRS 9			23,187,283	(276,364,626)	(253,177,343)	(253,177,343)
As restated	**775,000,000**	**490,500**	**223,187,283**	**350,136,567**	**573,323,850**	**1,348,814,350**
Total comprehensive income for the year		(427,500)		20,337,603	20,337,603	19,910,103
Reversal of appropriation			(3,585,850)	3,585,850		0
Balance at December 31, 2018	**775,000,000**	**63,000**	**219,601,433**	**374,060,020**	**593,661,453**	**1,368,724,453**

The Notes on pages 10 to 61 form part of these financial statements

UCPB Leasing and Finance Corporation
(A wholly owned subsidiary of United Coconut Planters Bank)
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2019 and 2018
(Amounts in Philippine Peso)

	Note	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before tax		71,108,793	1,003,518
Adjustments for:			
Impairment and credit losses	17.2	16,963,044	75,562,924
Gain on sale of receivables	17.1	(2,992,378)	(11,597,333)
Gain on foreclosure	17.1	(5,131,432)	(2,315,525)
Depreciation and amortization	17.2	22,355,108	15,953,883
Loss (gain) on sale of assets acquired	17.1	4,134	5,275,823
Equity share in net earnings of a subsidiary	9	(168,528)	(167,204)
Net Operating profit before working capital changes		**102,138,741**	**83,716,086**
Decrease/(increase) in loans and receivables		(87,029,882)	78,539,523
Increase in other assets		(56,488,445)	(8,963,674)
Decrease/(increase) in accounts payables and other liabilities		(40,148,983)	43,356,547
Decrease in deposit on lease contracts		11,274,288	10,474,412
Cash generated/(used) in operations		**(70,254,281)**	**207,122,894**
Cash paid for income taxes		(2,172,901)	(111,322)
Net cash generated/(used) in operating activities		**(72,427,182)**	**207,011,572**
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from disposal of property and equipment	11	786,489	315,434
Acquisitions of property and equipment	11	(1,463,411)	(1,510,259)
Net cash used in investing activities		**(676,922)**	**(1,194,825)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayments of bills payable	22	(2,577,083,334)	(2,062,749,490)
Proceeds from availments of bills payable	22	2,690,000,000	1,860,300,000
Net cash generated/(used) in investing activities		**112,916,666**	**(202,449,490)**
NET INCREASE) IN CASH AND CASH EQUIVALENTS		**39,812,562**	**3,367,257**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		**93,683,945**	**90,316,688**
CASH AND CASH EQUIVALENTS AT END OF YEAR	7	**133,496,507**	**93,683,945**

The Notes on pages 10 to 61 form part of these financial statements

UCPB LEASING AND FINANCE CORPORATION
(A Wholly Owned Subsidiary of United Coconut Planters Bank)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018
(Amounts in Philippines Pesos)

1. CORPORATE INFORMATION

1.1 General Information

UCPB Leasing and Finance Corporation (the Company) is a domestic corporation incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) under SEC Registration No. AS00158561 on January 2, 1989 as a finance company under Republic Act (RA) No. 8556, *The Financing Company Act of 1998*, (the Financing Company Act). The Company is presently engaged in providing services such as lease financing, check discounting and trade receivable financing.

The Company is a wholly owned subsidiary of United Coconut Planters Bank (UCPB or the Parent Bank), a universal bank incorporated and domiciled in the Philippines organized to provide expanded commercial banking services such as deposit products, loans and trade finance, domestic and foreign fund transfers, treasury, foreign exchange investment banking and trust services.

As of December 31, 2019 and 2018, the Company holds 100 per cent ownership interest in United Foreign Exchange Corporation (UFEC), a domestic company primarily engaged in dealing of foreign currencies and financial instruments.

In September 2010, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP) approved the Company's application to engage in quasi-banking functions. In January 2012, however, the Company decided to cancel its quasi-banking license and the BSP approved its immediate revocation on April 26, 2012.

On August 18, 2017, the SEC approved the change in the registered principal office of the Company from 14th Floor, UCPB Building, 7907 Makati Avenue, Makati City to 6th Floor, UCPB Corporate Offices, 7907 Makati Avenue, Makati City. On August 20, 2018, the Bureau of Internal Revenue (BIR) approved such change in the registered principal office.

1.2 Approval of Financial Statements

The financial statements of the Company as of and for the year ended December 31, 2019 (including the comparative financial statements as of and for the year ended December 31, 2018) were authorized for issue by the Company's Board of Directors on July 30, 2020.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these financial statements are summarized below and in the succeeding pages. These policies have been consistently applied to all the 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 Company have been prepared in accordance with Philippine Financial Reporting Standards (PFRSs). PFRSs are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board and approved by the Philippine Board of Accountancy.

The financial statements have been prepared using the measurement bases specified by PFRSs for each type of asset, liability, income and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) Presentation of Financial Statements

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements*. The Company presents the statement of comprehensive income separate from the statement of income.

The Company presents a third statement of financial position as at the beginning of the preceding period when it 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. The related notes to the third statement of financial position are not required to be disclosed.

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

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

2.2 Adoption of New and Amended PFRS

(a) Effective in 2019 that are Relevant to the Company

The Company adopted for the first time the following new PFRS, amendments, interpretation and annual improvements to PFRS, which are mandatorily effective for annual periods beginning on or after January 1, 2019:

(i) PFRS 16, Leases. The new standard supersedes PAS 17, Leases, and its related interpretation IFRIC 4, Determining Whether an Arrangement Contains a Lease. For lessees, it requires to account for leases "on balance sheet" by recognizing a "right-of-use" asset and a lease liability. The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is reasonably certain. In subsequent periods, the "right-of-use" asset is accounted for similar to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similar to a financial liability that is amortized using the effective interest method. However, the new standard provides important reliefs or exemptions for short-term leases and leases of low value assets. If these exemptions are used, the accounting is similar to operating lease accounting under PAS 17 where lease payments are recognized as expenses on a straight-line basis over the lease term or another systematic (if more representative of the pattern of the lessee's benefit).

For lessors, lease accounting is similar to PAS 17. In particular, the distinction between finance and operating leases is retained. The definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as PAS 17. The basic accounting mechanics are also similar, but with some different or more explicit guidance in few areas. These include variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

For leases previously accounted for as operating leases with remaining lease term of less than 12 months and for leases of low-value assets, the Management has applied the optional exemption to not recognize right-of-use assets but to account for the lease expense on a straight-line basis over the remaining lease term.

On the date of transition, the company has lease agreement for its office space with the parent bank from August 15, 2017 to July 15, 2022. The company elected to recognize the ROU asset and liability by applying the retroactive modified approach effective January 2, 2019. (see Note 11 and 14)

(ii) IFRIC 23, *Uncertain over Income Tax Treatments*. The interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Company to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be based on the accepted tax treatment. Otherwise, the Company has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above.

The Company's adoption of the Interpretation did not result in any changes in its accounting policies and the Management determined that it is probable that its income tax treatments will be accepted by the taxation authorities, thus, the adoption of this new standard has no impact on the Company's financial statements.

(b) Effective in 2019 but not Relevant to the Company

The following amendments and annual improvements to existing standards are mandatorily effective for annual periods beginning on or after January 1, 2019 but are not relevant to the Company's financial statements:

PFRS 9 (Amendments)	:	Financial Instruments – Prepayment Features with Negative Compensation
PAS 19 (Amendments)	:	Employee Benefits: Plan Amendment, Curtailment or Settlement
PAS 28 (Amendments)	:	Investments in Associates and Joint Ventures – Long Term Interests in Associates and Joint Ventures

Annual Improvements to PFRS (2015-2017 Cycle)

PFRS 3	:	Business Combinations, and PFRS 11, Joint Arrangements – Previously held interest in a joint operation
PAS 12	:	Income Taxes – Income tax consequence of payments on financial instruments classified as equity
PAS 23	:	Borrowing Costs – Borrowing costs eligible for capitalization

(c) Effective Subsequent to 2019 but not Adopted Early

There are new PFRS, amendments, interpretations and annual improvements to existing standards effective for annual periods subsequent to 2019, which are adopted by the FRSC. Management will adopt the following relevant pronouncements in accordance with their transitional provisions; and, unless otherwise stated, none of these are expected to have significant impact on the Company's financial statements:

(i) PFRS 3 (Amendments), Business Combinations: Definition of a Business (effective from January 1, 2020). The amendments clarify the minimum requirements to be a business, remove the assessment of a market participant's ability to replace missing elements, and narrow the definition of outputs. The amendments also add guidance to assess whether an acquired process is substantive and add illustrative examples. An optional fair value concentration test is introduced which permits a simplified assessment of whether an acquired set of activities and assets is not a business.

(ii) PAS 1 (Amendments), Presentation of Financial Statements, and PAS 8, Accounting Policies, Changes in Accounting Estimates and Errors: Definition of Material (effective from January 1, 2020). The amendments refine the definition of material in PAS 1 and align the definitions used across PFRS and other pronouncements. They are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments.

2.3 Separate Financial Statements and Investment in a Subsidiary

These financial statements are prepared as the Company's separate financial statements. As allowed under existing financial reporting standards, the Company has not presented consolidated financial statements because it is itself a wholly owned subsidiary of UCPB, which presents consolidated financial statements available for public use that comply with PFRSs. Moreover, the Company's debt or equity securities are not traded in organized financial market and the Company is not in the process of filing its financial statements with securities commissions or other regulatory organization for the purpose of issuing any class of instruments in an organized financial market.

A subsidiary is an entity over which the Company has control. The Company controls an entity when (i) it has power over the entity; (ii) it is exposed, or has rights to, variable returns from its involvement with the entity; and, (iii) it has the ability to affect those returns through its power over the entity. The Company reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of controls indicated above.

The Company's investment in a subsidiary is accounted for in these separate financial statements using the equity method. Under the equity method, all subsequent changes to the ownership interest in the equity of the subsidiary are recognized in the Company's carrying amount of the investment. Changes resulting from the profit or loss generated and the changes in other comprehensive income by the subsidiary is credited or charged against the Equity Share in Net Earnings of a Subsidiary and Other Comprehensive Income (Loss) account in the statements of comprehensive income.

Impairment loss is provided when there is objective evidence that the investment in a subsidiary will not be recovered (see Note 2.13).

2.4 Financial Assets

Financial assets are recognized when the Company becomes a party to the contractual terms of the financial instrument. For purposes of classifying financial assets, an instrument is considered as an equity instrument if it is non-derivative and meets the definition of equity for the issuer in accordance with the criteria of PAS 32, *Financial Instruments: Presentation*. All other non-derivative financial instruments are treated as debt instruments.

(a) Classification, Measurement and Reclassification of Financial Assets in Accordance with PFRS 9

Under PFRS 9, the classification and measurement of financial assets is driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. All of the Company's financial assets are currently categorized as financial assets at amortized cost.

Financial assets are measured at amortized cost if both of the following conditions are met:

- the asset is held within the Company's business model whose objective is to hold financial assets in order to collect contractual cash flows("hold to collect"); and,

- the contractual terms of the instrument give rise, on specified dates, to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

Except for trade receivables that do not contain a significant financing component and are measured at the transaction price in accordance with PFRS 15, all financial assets meeting these criteria are measured initially at fair value plus transaction costs. These are subsequently measured at amortized cost using the effective interest method, less any impairment in value.

The Company's financial assets at amortized cost are presented in the statements of financial position as Cash and Cash Equivalents, Loans and Receivables and Refundable deposits under Other Assets account

For purposes of cash flows reporting and presentation, cash and cash equivalents comprise accounts with original maturities of three months or less, including cash. These generally include cash on hand, demand deposits and short-term, highly liquid investments with original maturities of three months or less, readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

(b) Recognition of Interest and Leasing Income Using Effective Interest Rate Method

Interest income on financial assets measured at amortized cost is recognized using the effective interest rate (EIR) method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of EIR. The Company recognizes interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, it recognizes the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

The interest income on finance lease receivables is allocated over the lease term on a systematic and rational basis. The recognition of interest income on finance lease is based on a pattern reflecting a constant periodic rate of return on the Company's net investment in the finance lease. Lease payments relating to the period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset in the Statements of Financial Position with an increase or reduction in interest income.

The Company calculates interest income by applying the EIR to the gross carrying amount of financial assets, except for those that are subsequently identified as credit-impaired and or are purchased or originated credit-impaired assets.

For financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the net carrying amount of the financial assets (after deduction of the loss allowance). If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis. For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying a credit-adjusted effective interest rate to the amortized cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset subsequently improves.

(c) Impairment of Financial Assets Under PFRS 9

From January 1, 2018, the Company assesses its expected credit losses (ECL) on a forward-looking basis associated with its financial assets at amortized cost. Recognition of credit losses is no longer dependent on Company's identification of a credit loss event. Instead, the Company considers a broader range of information in assessing credit risk and measuring expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect collectability of the future cash flows of the financial assets.

For these financial instruments, the allowance for credit losses is based on 12-month ECL associated with the probability of default of a financial instrument in the next 12 months (referred to as 'Stage 1' financial instruments). Unless there has been a significant increase in credit risk subsequent to the initial recognition of the financial asset, a lifetime ECL (which are the expected shortfalls in contractual cash flows, considering the potential for default at any point during the life of the financial asset) will be recognized (referred to as 'Stage 2' financial instruments). 'Stage 2' financial instruments also include those loan accounts and facilities where the credit risk has improved and have been reclassified from 'Stage 3'. A lifetime ECL shall be recognized for 'Stage 3' financial instruments, which include financial instruments that are subsequently credit-impaired, as well as purchased or originated credit impaired assets.

The Company's definition of credit risk and information on how credit risk is mitigated by the Company are disclosed in Note 4.2.

The key elements used in the calculation of ECL are as follows:

- *Probability of default (PD)* – It is an estimate of likelihood of a borrower defaulting on its financial obligation over a given time horizon.

- *Loss given default (LGD)* – It is an estimate of loss arising in case where a default occurs at a given time. It is based on the difference between the contractual cash flows of a financial instrument due from a counterparty and those that the Company would expect to receive, including the realization of any collateral.

- *Exposure at default (EAD)* – It represents the gross carrying amount of the financial instruments subject to the impairment calculation. In case of a loan commitment, the Company shall include the undrawn balance (up to the current contractual limit) at the time of default should it occur.

The Company measures the ECL of a financial asset in such manner that reflects: (i) the time value of money; and, (ii) reasonable and supportable information about past events, current conditions and forecasts of future economic conditions that affect the collectability of the future cash flows of the financial assets.

Measurement of the ECL is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

The Company's detailed ECL measurement as determined by the management is disclosed in Note 4.2.

(d) Derecognition of Financial Assets

The financial assets (or where applicable, a part of a financial asset or part of a group of financial assets) are derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

2.5 Property and Equipment

All items of property and equipment are stated at cost less accumulated depreciation and amortization and any impairment in value.

The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized while expenditures for repairs and maintenance are charged to expense as incurred.

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

Furniture, fixtures and office equipment	5 years
Transportation equipment	5 years

Leasehold improvements are amortized over the estimated useful lives of the assets of five years or the terms of the lease, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.13).

The residual values estimated useful lives and method of depreciation and amortization of property and equipment are reviewed, and adjusted if appropriate, at the end of each reporting period.

An item of property and equipment, including the related accumulated depreciation, amortization and impairment losses, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the year the item is derecognized.

Right-of-use assets recognized under PFRS 16 were presented in the statements of financial position as part of Property, Plant and Equipment.

2.6 Investment Properties

Investment properties represent properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes.

The Company measures investment properties, which include land and building acquired by the Company from defaulting borrowers, under the cost model. The cost of an investment property comprises its purchase price and directly attributable costs incurred. Cost is initially recognized at fair value of the investment properties unless: (i) the exchange transaction lacks commercial substance; or, (ii) neither the fair value of the asset received nor the asset given up can be reliably measured. The difference between the fair value of the asset received, as determined by professional appraisers, and the carrying amount of the loan settled through foreclosure is recognized as Gain or loss on foreclosure under the Other Income account in the statements of income. Investment properties, except land, are depreciated using the straight-line basis over the estimated useful lives of the assets ranging from five to ten years.

Direct operating expenses, such as repairs and maintenance and real estate taxes are normally charged against current operations in the year in which these costs are incurred.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.13).

Investment properties are derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of investment properties is recognized as Gain or loss on sale of assets acquired under the Other Income account in the year of retirement or disposal.

2.7 Other Properties Acquired

Other properties acquired include chattel acquired in settlement of loan receivables. These are stated at cost, which is the fair value at recognition date, less accumulated depreciation and any impairment in value.

The Company applies the cost model in accounting for other properties acquired.

Depreciation is computed on a straight-line basis over the estimated useful life of three to five years. The estimated useful life and the depreciation method are reviewed periodically to ensure that the period and the method of depreciation are consistent with the expected pattern of economic benefits from items of other properties acquired.

The carrying values of other properties acquired are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amounts (see Note 2.13).

2.8 Financial Liabilities

Financial liabilities, which include bills payable, deposit on lease contracts and accounts payables and other liabilities (except tax-related liabilities) are recognized when the Company becomes a party to the contractual terms of the instrument. All interest-related charges incurred on a financial liability are recognized as an expense in profit or loss as part of Interest Expense in the statements of income.

Bills payable are raised to support the long-term funding of operations. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are charged to profit or loss on an accrual basis using the effective interest method and are added to the carrying amount of the instrument to the extent that these are not settled in the period in which they arise.

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

Dividend distributions to shareholders are recognized as financial liabilities upon declaration by the Company.

Financial liabilities are derecognized from the statements of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between the carrying amount of the financial liability derecognized and the consideration paid or payable is recognized in profit or loss.

2.9 Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the resulting net amount, considered as a single financial asset or financial liability, is reported in the statements of financial position when the Company currently has 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. The right of set-off must be available at the end of the reporting period, that is, it is not contingent on a future event. It must also be enforceable in the normal course of business, in the event of default, and in the event of insolvency or bankruptcy; and must be legally enforceable for both entity and all counterparties to the financial instruments.

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. A present obligation arises from the presence of a legal or constructive obligation that has resulted from past events.

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. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the statements of financial position. Similarly, possible inflows of economic benefits to the Company that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the statements of financial position. On the other hand, any reimbursement that the Company can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

2.11 Revenue and Expense Recognition

Prior to January 1, 2018, revenue is recognized to the extent that the revenue can be reliably measured; it is probable that future economic benefits will flow to the Company; and the expenses and costs incurred and to be incurred can be measured reliably. Upon adoption of PFRS 15 beginning January 1, 2018, revenue is recognized only when (or as) the Company satisfies a performance obligation by transferring control of the promised services to the customer. A contract with a customer that results in a recognized financial instrument in the Company's financial statements may be partially within the scope of PFRS 9 and partially within the scope of PFRS 15. In such case, the Company first applies

PFRS 9 to separate and measure the part of the contract that is in-scope of PFRS 9, and then applies PFRS 15 to the residual part of the contract. Expenses and costs, if any, are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. All finance costs are reported in profit or loss on accrual basis.

To determine whether to recognize revenue, the Company follows a five-step process:

(1) identifying the contract with a customer;
(2) identifying the performance obligation;
(3) determining the transaction price;
(4) allocating the transaction price to the performance obligations; and,
(5) recognizing revenue when/as performance obligations are satisfied.

For Step 1 to be achieved, the following five gating criteria must be present:

(i) the parties to the contract have approved the contract either in writing, orally or in accordance with other customary business practices;
(ii) each party's rights regarding the goods or services to be transferred or performed can be identified;
(iii) the payment terms for the goods or services to be transferred or performed can be identified;
(iv) the contract has commercial substance (i.e., the risk, timing or amount of the future cash flows is expected to change as a result of the contract); and,
(v) collection of the consideration in exchange of the goods and services is probable.

Revenue is recognized only when (or as) the Company satisfies a performance obligation by transferring control of the promised goods or services to a customer. The transfer of control can occur over time or at a point in time.

A performance obligation is satisfied at a point in time unless it meets one of the following criteria, in which case it is satisfied over time:

(i) the customer simultaneously receives and consumes the benefits provided by the Company's performance as the Company performs;

(ii) the Company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; and,

(iii) the Company's performance does not create an asset with an alternative use to the Company and the Company has an enforceable right to payment for performance completed to date.

The Company also earns service fees related to the Company's factoring receivables which are supported by contracts and approved by the parties involved. These revenues are accounted for by the Company in accordance with PFRS 15.

The Company assesses its revenue arrangements against specific criteria in order to determine if it is acting as a principal or agent. The Company concluded that it is acting as a principal in all of its revenue arrangements.

The following specific recognition criteria must also be met before revenue is recognized:

(a) Revenues within the scope of PFRS 15

(i) Penalties and Service fees

Penalties and service fees are recognized only upon collection or accrued when there is reasonable degree of certainty as to its collectability.

(ii) Gain (Loss) on Sale of Assets Acquired

Gain (loss) on sale of assets acquired arises from the disposals of investment properties and other properties acquired. Revenue is recognized when the risks and rewards of ownership of the assets is transferred to the buyer and when the collectability of the entire sales price is reasonably assured.

(iii) Miscellaneous Income

Income from the sale of services is recognized upon completion of service.

(b) Revenues outside the scope of PFRS 15

(i) Interest and Leasing Income

Interest and leasing income are recognized in profit or loss for all financial instruments measured at amortized cost using the EIR method of accounting.

(ii) Gain (Loss) on Foreclosures

Gain (loss) on foreclosed assets is recognized upon derecognition of existing receivables through foreclosure of assets used as collateral and is determined as the difference between the fair value of the foreclosed asset and the net carrying amount of the receivable settled.

(iii) Gain (Loss) on Sale of Receivables

Gain (loss) on sale of receivables is recognized upon sale of loans and receivables, without recourse, wherein the selling price is greater (less) than the carrying amount of loans and receivables sold.

Costs and expenses are recognized in the statements of income upon utilization of the resources and/or services or at the date they are incurred. All finance costs are reported on an accrual basis, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset, if any (see Note 2.14).

2.12 Leases

The Company accounts for its leases as follows:

(a) Company as Lessee

(i) Accounting for Leases in Accordance with PFRS 16 (2019)

For any new contracts entered into on or after January 1, 2019, the Company considers whether a contract is, or contains, a lease. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. To apply this definition, the Company assesses whether the contract meets three key evaluations which are:

- the contract contains an identified asset, which is either explicitly identified in the contract or implicitly specified by being identified at the time the asset is made available to the Company;

- the Company has the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use, considering its rights within the defined scope of the contract; and,

- the Company has the right to direct the use of the identified asset throughout the period of use. The Company assess whether it has the right to direct 'how and for what purpose' the asset is used throughout the period of use.

At lease commencement date, the Company recognizes a right-of-use asset and a lease liability in the statements of financial position. The right-of-use asset is measured at cost, which is made up of the initial measurement of the lease liability, any initial direct costs incurred by the Company, an estimate of any costs to dismantle and remove the asset at the end of the lease, and any lease payments made in advance of the lease commencement date (net of any incentives received). Subsequently, the Company depreciates the right-of-use asset on a straight-line basis from the lease commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The Company also assesses the right-of-use asset for impairment when such indicators exist.

On the other hand, the Company measures the lease liability at the present value of the lease payments unpaid at the commencement date, discounted using the interest rate implicit in the lease if that rate is readily available or the company's incremental borrowing rate. Lease payments include fixed payments (including in-substance fixed) less lease incentives receivable, if any, variable lease payments based on an index or rate, amounts expected to be payable under a residual value guarantee, and payments arising from options (either renewal or termination) reasonably certain to be exercised. Subsequent to initial measurement, the liability will be reduced for payments made and increased for interest. It is remeasured to reflect any reassessment or modification, or if there are changes in in-substance fixed payments. When the lease liability is remeasured, the corresponding adjustment is reflected in the right-of-use asset, or profit and loss if the right-of-use asset is already reduced to zero.

The Company has elected to account for short-term leases and leases of low-value assets using the practical expedients. Instead of recognizing a right-of-use asset and lease liability, the payments in relation to these are recognized as an expense in profit or loss on a straight-line basis over the lease term.

Right-of-use assets and lease liabilities were presented in the statements of financial position as part of Property, Plant and Equipment and Other Liabilities, respectively (see Note 11 and 14).

(ii) Accounting for Leases in Accordance with PAS 17 (2018)

Leases which do not transfer to the Company substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments (net of any incentive received from the lessor) 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.
The Company determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific or identified asset or assets and the arrangement conveys a right to use the asset for a period of time in exchange for consideration.

(b) Company as Lessor

Leases wherein the Company substantially transfers to the lessee all risks and benefits incidental to ownership of the leased item are classified as finance leases and are presented as receivable at an amount equal to the Company's net investment in the lease. Finance income is recognized based on the pattern reflecting a constant periodic rate of return on the Company's net investment outstanding in respect of the finance lease.

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.

The Company determines whether an arrangement is, or contains, a lease based on the substance of the arrangement. It makes an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.13 Impairment of Non-financial Assets

The Company's investment in a subsidiary, property and equipment, investment properties and other non-financial assets are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable.

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

Impairment loss is recognized in profit or loss for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amounts which is the higher of its fair value less costs to sell and its value in use. In determining value in use, management estimates the expected future cash flows from each cash-generating unit and determines the suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Company's latest approved budget, adjusted as necessary to exclude the effects of asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss is reversed if the asset's or cash generating unit's recoverable amount exceeds its carrying amount.

2.14 Borrowing Costs

Borrowing costs are recognized as expenses in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are complete.

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

2.15 Income Taxes

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax 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 using 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 profit or loss.

Deferred tax is accounted for using the liability method, on temporary differences at the end of each reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled provided such tax rates have been enacted or substantively enacted at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

Deferred tax assets and deferred tax liabilities are offset if the Company has a legally enforceable right to set off current tax assets against current tax liabilities and the deferred taxes relate to the same entity and the same taxation authority.

2.16 Related Party Transactions and Relationships

Related party transactions are transfers of resources, services or obligations between the Company 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 parties include: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Company; (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 Company and close members of the family of any such individual.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

2.17 Equity

Capital stock represents the nominal value of shares that have been issued.

Revaluation reserves represent the accumulated share in other comprehensive income of a subsidiary.

Appropriated retained earnings pertain to the following:

(a) Accumulated amount set aside for stock dividend declaration purposes.

(b) Accumulated amount of appropriation from unappropriated retained earnings made by the Company arising from the excess of the one per cent general loan loss provisions for outstanding loans as required by the BSP under Circular No. 1011, *Guidelines on the Adoption of PFRS 9* over the computed allowance for ECL for Stage 1 financial instruments.

Unappropriated retained earnings represent all current and prior period results of operations as reported in the profit or loss section of the statements of comprehensive income, reduced by the amounts of dividends declared, if any.

2.18 Events After the End of the Reporting Period

Any post-year-end event that provides additional information about the Company's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Company's financial statements in accordance with PFRSs requires management to make judgments and estimates that affect the 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 the circumstances. Actual results may ultimately differ from these estimates.

3.1 Critical Management Judgments in Applying Accounting Policies

In the process of applying the Company's accounting policies, management has made the following judgments, apart from those involving estimation, which have the most significant effect on the amounts recognized in the financial statements:

(a) Evaluation of Business Model Applied in Managing Financial Instruments

Upon adoption of PFRS 9, the Company developed business models which reflect how it manages its portfolio of financial instruments. The Company's business models need not be assessed at entity level or as a whole but shall be applied at the level of a portfolio of financial instruments (i.e., group of financial instruments that are managed together by the Company) and not on an instrument-by-instrument basis (i.e., not based on intention or specific characteristics of individual financial instrument).

In determining the classification of a financial instrument under PFRS 9, the Company evaluates in which business model a financial instrument or a portfolio of financial instruments belong to taking into consideration the objectives of each business model established by the Company (e.g., held-for-trading, generating accrual income, direct matching to a specific liability) as those relate to the Company's investment and trading strategies.

(b) Testing the Cash Flow Characteristics of Financial Assets and Continuing Evaluation of the Business Model

In determining the classification of financial assets under PFRS 9, the Company assesses whether the contractual terms of the financial assets give rise on specified dates to cash flows that are solely for payment of Principal and Interest (SPPI) on the principal outstanding, with interest representing time value of money and credit risk associated with the principal amount outstanding. The assessment as to whether the cash flows meet the test is made in the currency in which the financial asset is denominated. Any other contractual term that changes the timing or amount of cash flows (unless it is a variable interest rate that represents time value of money and credit risk) does not meet the amortized cost criteria. In cases where the relationship between the passage of time and the interest rate of the financial instrument may be imperfect, known as modified time value of money, the Company assesses the modified time value of money feature to determine whether the financial instrument still meets the SPPI criterion. The objective of the assessment is to determine how different the undiscounted contractual cash flows could be from the undiscounted cash flows that would arise if the time value of money element was not Company modified (the benchmark cash flows). If the resulting difference is significant, the SPPI criterion is not met. In view of this, the Company considers the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument.

In addition, PFRS 9 emphasizes that if more than an infrequent sale is made out of a portfolio of financial assets carried at amortized cost, if any, an entity should assess whether and how such sales are consistent with the objective of collecting contractual cash flows. In making this judgement, the Company considers certain circumstances documented in its business model manual to assess that an increase in the frequency or value of sales of financial instruments in a particular period is not necessary inconsistent with a held-to-collect business model if the Company can explain the reasons for those sales and why those sales do not reflect a change in the Company's objective for the business model.

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

The Company determines whether a property qualifies as investment property. In making its judgment, the Company considers whether the property generates cash flows largely independent of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to the property but also to other assets used in the production or supply process.

(d) Classification of Acquired Properties

The Company classifies its acquired properties as Property and equipment under Other Assets account if used in operations, as Other properties acquired under Other Assets account if the Company expects that the properties will be recovered principally through sale rather than continuing use of the asset, as Investment Properties if held for currently undetermined future use and is regarded as held for capital appreciation.

(e) Recognition of Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition of provisions and contingencies are discussed in Note 2.10 and disclosures on relevant provisions and contingencies are presented in Note 21.

3.2 Key Sources of Estimation Uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have significant risks of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period:

(a) Estimation of Allowance for ECL

When measuring allowance for ECL for relevant categories of financial assets, management applies judgment in defining the criteria in assessing whether a financial asset has experienced significant increase in credit risk (SICR) since initial recognition, and in the estimation of the contractual cash flows due from counterparty and those that the Company would expect to receive, taking into account the cash flows from the realization of collateral and integral credit enhancements. The Company's ECL calculations are outputs of complex models with a number of underlying assumptions about future economic conditions and credit behavior of counterparties (e.g., the likelihood of counterparties defaulting and the resulting losses). The computation of the ECL also consider the use of reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other that may result in different levels of loss allowance.

Significant factors affecting the estimates on the ECL model include:

- internal rating matrix which determines the PD to be assigned to a financial asset;
- criteria for assessing if there has been a SICR and when a financial asset will be transferred between the three stages;
- the Company's definition of default for different segments of credit exposures that considers the regulatory requirements;
- establishing groups of similar financial assets (i.e., segmentation) for the purposes of measuring ECL on a collective basis;
- establishment of LGD parameters based on historical recovery rates of claims against defaulted counterparties across different group of financial instruments; and,
- establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL.

The explanation of inputs, assumptions and estimation techniques used in measuring ECL and the analysis of the allowance for ECL on various groups of financial instruments is further discussed in Note 4.2.

(b) Impairment of Loans and Receivables

The Company reviews its loans and receivables portfolio to assess impairment at least on an annual basis. In determining whether an impairment loss should be recognized in profit or loss, the Company makes judgment as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from the portfolio before the decrease can be identified with an individual item in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers or issuers in a group, or national or local economic conditions that correlates with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

The carrying value of loans and receivables and the analysis of allowance for impairment on such financial assets are shown in Note 8.

(c) Estimation of Useful Lives of Investment Properties and Property and Equipment

The Company estimates the useful lives of investment properties and property and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of investment properties and other 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.

The carrying amounts of investment properties and property and equipment are analyzed in Notes 10 and 11, respectively. Based on management's assessment as at December 31, 2019 and 2018, there is no change in estimated useful lives of those assets during those years. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(d) Fair Value Measurements of Investment Properties and Other Properties Acquired

The Company's investment properties and other properties acquired consist of parcels of land and buildings and machineries and other equipment which are held for capital appreciation or held under operating lease agreements, and are measured using the cost model. The estimated fair values of investment properties and other properties acquired as disclosed in Note 6.3 are determined on the basis of appraisals conducted by in-house and independent professional appraisers applying the relevant valuation methodologies as discussed therein.

For investment properties with appraisal conducted prior to the end of the current reporting period, management determines whether there are significant circumstances during the intervening period that may require adjustments or changes in the disclosure of fair value of those properties.

A significant change in key inputs and sources of information used in the determination of the fair value disclosed for those assets may result in an adjustment in the carrying amount of the assets reported in the financial statements if their fair value will indicate evidence of impairment.

(e) Determination of Realizable Amount of Deferred Tax Assets

The Company 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. Management assessed that the deferred tax assets recognized as at December 31, 2019 and 2018 will be fully utilized in the coming years. The carrying value of deferred tax assets as of those dates is disclosed in Note 19.

(f) Impairment of Non-financial Assets

In assessing impairment, management estimates the recoverable amount of each asset or a cash-generating unit based on expected future cash flows and uses an interest rate to calculate the present value of those cash flows. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate (see Note 2.13). Though management believes that the assumptions used in the estimation of fair values reflected in the financial statements are appropriate and reasonable, significant changes in those assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

Impairment losses recognized on Investment Properties and Property and Equipment are discussed in Notes 10 and 11, respectively.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is exposed to a variety of financial risks which result from both its operating, investing and financing activities and the business in which it operates.

The Company's risk management is coordinated with its parent company, in close cooperation with the Board of Directors, and focuses on actively securing the Company's short to medium-term cash flows by minimizing the exposure to financial markets.

The Company does not engage in the trading of financial assets for speculative purposes nor does it write options. The significant financial risks to which the Company is exposed to are described below and in the succeeding pages.

4.1 Interest Rate Risk

Interest rate risk arises from the differences between the timing of the rate changes and the timing of cash flows (repricing risk). At December 31, 2019 and 2018, the Company is exposed to changes in market interest rates through its cash and cash equivalents, loans and receivables and bills payable. All other financial assets and financial liabilities are non-interest bearing.

The Company's cash and cash equivalents are subject to insignificant risk of changes in value. Loans and receivables and bills payable have fixed interest rates throughout their short term durations and are not sensitive to prevailing market rate fluctuations.

The Company carefully analyzes interest rate risk exposure based on the interest rate gap of its portfolio of cash and cash equivalents, loans and receivables and bills payable. The focus of the analysis is the impact of changes in interest rates of its interest sensitive liabilities relative to the fixed interest rate for its loans and receivables. The Company ensures that its loanable funds are offered to borrowers at a reasonable price and interest which would give favorable interest margin over the term of the instruments. In certain cases, the Company will reprice its loans and leases depending on the agreement with customers and/or market price.

The interest rate gap analyses as of December 31, 2019 and 2018 are presented below.

	One to Three Months	Three Months to One Year	One to Five Years	More Than Five Years	Total
Assets:					
Cash and cash equivalents	133,496,507	0	0	0	133,496,507
Loans and receivables*	2,078,665,987	150,517,522	363,978,726	394,691,065	2,987,853,300
	2,212,162,494	150,517,522	363,978,726	394,691,065	3,121,349,807
Liability:					
Bills payable	636,250,000	588,750,000	2,083,333	0	1,227,083,333
Periodic gap	1,575,912,494	(438,232,478)	361,895,393	394,691,065	1,894,266,474
Cumulative gap	1,575,912,494	1,137,680,016	1,499,575,409	1,894,266,474	1,894,266,474

			2018		
	One to Three Months	Three Months to One Year	One to Five Years	More Than Five Years	Total
Assets:					
Cash and cash equivalents	93,683,945	0	0	0	93,683,945
Loans and receivables*	816,034,970	382,477,548	1,814,626,780	60,142,067	3,073,281,365
	909,718,915	382,477,548	1,814,626,780	60,142,067	3,166,965,310
Liability:					
Bills payable	932,500,000	181,666,667	0	0	1,114,166,667
Periodic gap	(22,781,085)	200,810,881	1,814,626,780	60,142,067	2,052,798,643
Cumulative gap	(22,781,085)	178,029,796	1,992,656,576	2,052,798,643	2,052,798,643

**Loans and receivables subjected to credit risk assessments exclude residual value, deferred leasing income, unearned finance income, capitalized interest and other charges, other receivables and allowance for credit and impairment losses.*

4.2 Credit Risk

Credit risk is the risk of financial loss if a counterparty to a financial instrument may fail to meet its contractual obligations to the Company. Credit risk is found in all activities where success depends on counterparty, issuer or borrower performance. It arises any time when the Company funds are extended, committed, invested or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the statements of financial position. Credit risk is not limited to the loan portfolio. The Company uses risk asset acceptance criteria when initially considering a prospect. When the prospect does not meet these criteria, the Company normally does not further pursue the account. When the prospect passes the criteria, the Company performs qualitative and quantitative analyses to determine creditworthiness of the prospect. The qualitative analysis includes evaluation of the borrower's ownership, management, product, production/process, industry, security and collateral, suppliers, customers, etc. The quantitative analysis includes review of past and present financial condition and future expectations based on assumptions and projections.

The Company is also required to follow rules and regulations of the BSP on directors, officers, stockholders and related interests (DOSRI), single borrower's limit, account classification, general and specific loan reserve policy and others. With respect to bank deposits, the Company's BOD approves the banks with which the Company shall deal with.

(a) Credit Risk Assessment

The Company's credit risk assessment is performed based on the different segments of financial asset portfolio such as lease contract, loans and finance receivables. The Company also established credit risk assessment procedures for sales contract receivables and other risk assets including accounts receivables.

Loans, regardless if the accounts have been fully paid, extended or renewed in subsequent year or period, are subjected to evaluation for possible losses. The Company's estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions (or industry performance), expected cash flows, and the passage of time. The assessment of credit risk of a portfolio of assets requires further estimations as to the PDs occurring, of the associated loss ratios, and of default correlations between counterparties; accordingly, such credit risk is measured using PD, LGD, and EAD, for purposes of measuring ECL.

The Company uses its 10-grade internal credit risk rating system (ICRRS) to determine any evidence of potential deterioration in the quality of an instrument that take into consideration both quantitative and qualitative criteria. The rating system classifies performing accounts from a scale of one (1) indicating an extremely strong capacity of the counterparty to meet financial commitments down to ratings lower than seven (7) demonstrating weakness in the counterparty's economic and financial condition that could lead to payment default on financial commitments. The model on risk ratings is assessed and updated regularly. Validation of the risk rating is performed by the Risk Management Division to maintain accurate and consistent risk ratings across the credit portfolio. Past due accounts and those that exhibit the characteristics of classified loans shall be risk-rated following the guidelines on credit classification per BSP Manual of Regulations for Non-Bank Financial Institutions and under Section 4178Q, i.e., Especially Mentioned, Substandard, Doubtful or Loss. These guidelines are used by the Company to assign the individually assessed loan within a particular portfolio segment to a specific stage category under the PFRS 9 loan impairment standards (i.e., Stage 1, 2, 3).

In the process of applying the Company's ICRRS in determining indications of impairment on the loans and receivables, the Company analyzes the credit quality of the borrowers and counterparties through a set of criteria and rating scale classified into the following:

Credit Quality	ICRR System Grade	Description
High grade	1	Excellent
	2	Strong
Standard grade	3	Good
	4	Satisfactory
	5	Acceptable
	6	Watchlist
Substandard grade	7	Especially mentioned
	8	Substandard
Impaired	9	Doubtful
	10	Loss

(1) *Excellent* – The rating is given to a borrower with a very low probability of going into default in the coming year. The borrower has a high degree of stability, substance and diversity and has access to public markets to raise substantial amounts of funds at any time; has a very strong debt service capacity and has conservative balance sheet leverage. The track record of the borrower in terms of profit is very good and exhibits highest quality under virtually all economic conditions.

(2) *Strong* – This rating is given to borrowers with low probability of going into default in the coming year. Normally has a comfortable degree of stability, substance and diversity. Under normal market conditions, borrower has good access to public markets to raise funds. Borrower has a strong market and financial position with a history of successful performance. Overall debt service capacity is deemed very strong; critical balance sheet ratios are conservative.

(3) *Good* – This rating is given to smaller corporations with limited access to public capital markets or to alternative financial markets. Probability of default is quite low and it bears some degree of stability and substance. However, borrower may be susceptible to cyclical changes and more concentration of business risk, by product or by market. Typical for this type of borrower is the combination of comfortable asset protection and an acceptable balance sheet structure.

The debt service capacity of the borrower is strong and has reported profits for the past three years and is expected to be profitable again in the current year.

(4) *Satisfactory* – This rating is given to a borrower where clear risk elements exist, the probability of default is somewhat greater and normally has limited access to public markets. The probability is reflected in volatility of earnings and overall performance. The borrower should be able to withstand normal business cycles, but any prolonged unfavorable economic period would create deterioration beyond acceptable levels. The borrower has the combination of reasonably sound asset and cash flow protection with adequate debt service capacity and has reported profits in the past year and is expected to report a profit in the current year.

(5) *Acceptable* – This rating is given to a borrower whose risk elements are sufficiently pronounced to withstand normal business cycles but any prolonged unfavorable economic and/or market period would create an immediate deterioration beyond acceptable levels. The risk to this borrower is still acceptable as there is sufficient cash flow either historically or expected for the future; new business or projected finance transaction; an existing borrower where the nature of the exposure represents a higher risk because of extraordinary developments but for which a decreasing risk within an acceptable period can be expected.

(6) *Watchlist* – This rating is given to a borrower which incurs net losses and has salient financial weaknesses, specifically in profitability, reflected on its financial statements. Credit exposure is not at risk of loss at the moment but performance of the borrower has weakened and unless present trends are reversed, could lead to losses.

(7) *Especially Mentioned* – This rating is given to a borrower that exhibits potential weaknesses that deserve management's close attention. No immediate threat to the repayment of the loan exists through normal course of business but factors may exist that could adversely affect the credit worthiness of the borrower.

(8) *Substandard* – This rating is given to a borrower where repayment of the loan, through normal course of business, may be in jeopardy due to adverse events. There exists the possibility of future losses to the institution unless given closer supervision.

(9) *Doubtful* – This rating is given to a borrower who is unable or unwilling to service debt over an extended period of time and near future prospects of orderly debt service is doubtful. Existing facts, conditions, and values make full collection or liquidation highly improbable and in which substantial loss is probable.

(10) *Loss* – This rating is given to a borrower whose loans or portions thereof are considered uncollectible. The collectible amount, with no collateral or which collateral is of little value, is difficult to measure and more practical to write-off than to defer even though partial recovery may be obtained in the future.

(b) *Exposure to Credit Risk*

The amount of loans and receivables, net of any allowances for impairment and unearned discount and interest, cash and cash equivalents and refundable deposits recorded in the statements of financial position represent the Company's maximum exposure to credit risk without taking into account the value of any collateral obtained.

The Company's financial assets subject to credit risks are categorized under loans and receivables and are broken down as follows:

	Note	**2019**	**2018**
Cash and cash equivalents	7	133,496,507	93,683,945
Loans and receivables	8	2,775,689,688	2,681,630,440
Refundable deposits	12	918,451	779,767
		2,910,104,646	2,776,094,152

As part of Company policy, bank deposits are only maintained with reputable financial institutions. Cash in banks which are insured by the PDIC up to a maximum coverage of

P0.50 million per depositor per banking institution, as provided for under R.A. No. 9576, *Amendment to Charter of PDIC*, are still subjected to credit risk.

The tables below show the credit quality per class of loans and receivables, based on the Company's rating system (gross of allowance for credit and impairment losses and unearned discounts) as of December 31, 2019.

	Stage 1	Stage 2	Stage 3	Total
Receivables from customers:				
High Grade	246,846,840	0	0	246,846,840
Standard Grade	1,690,996,672	397,093,432	103,100,154	2,191,190,258
Substandard Grade	0	99,597,351	188,553,963	288,151,314
Impaired	0	0	261,664,888	261,664,888
	1,937,843,512	496,690,783	553,319,005	2,987,853,300

An analysis of changes in the ECL allowances in 2019 is as follows:

	Stage 1	Stage 2	Stage 3	Total
Receivables from customers:				
Balance at January 1, 2019	0	2,126,032	491,532,388	493,658,420
Provisions (reversals)	0	0	16,520,113	16,520,113
Reclassifications/reallocation	5,612	7,189,205	(2,544,188)	4,650,629
Amounts written off	0	0	(185,261,449)	(185,261,449)
Transfer to/(from) Stage 1	307,663	0	(307,663)	0
Transfer to/(from) Stage 2	0	17,552,862	(17,552,862)	0
Transfer to/(from) Stage 3	(307,663)	(17,552,862)	17,860,525	0
	5,612	9,315,237	320,246,864	329,567,713
Other Receivables				
Balance at January 1, 2019	0	203,757	509,035	712,792
Provisions (reversals)	0	0	442,931	442,931
Reclassifications/reallocation	0	0	0	0
Amounts written off	0	0	0	0
Transfer to/(from) Stage 1	0	0	0	0
Transfer to/(from) Stage 2	0	(137,898)	137,898	0
Transfer to/(from) Stage 3	0	0	388,936	388,936
	0	65,859	1,478,800	1,544,659
	5,612	**9,381,096**	**321,725,664**	**331,112,372**

The breakdown of provision (recovery) for impairment losses for the period December 31, 2019 is shown below.

	Stage 1	Stage 2	Stage 3	Total
Receivables from customers	0	0	16,520,113	16,520,113
Other Receivables	0	0	442,931	442,931
	0	0	16,963,044	16,963,044

The amounts of "Transfers to (from)" include the changes in the ECL on the exposures transferred from one stage to another during the year.

The increase in the ECL allowances was driven by an increase in the gross size of the portfolio and movements between stages as a result of increase in credit risk and improvement in economic conditions.

(c) Collateral Held as Security and Other Credit Enhancements

The Company holds collateral against loans and receivables in the form of mortgage interests over property. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated, except when a loan is individually assessed as impaired.

	2019	**2018**
Against impaired		
Chattel mortgage	64,789,736	123,263,183
Real estate mortgage	1,067,400	46,834,486
Finance lease	18,886,179	154,725,980
Against neither past due but not impaired		
Chattel mortgage	599,362,759	543,253,716
Real estate mortgage	13,969,872	80,154,118
Finance lease	640,834,138	882,885,290
	1,338,910,084	1,831,116,773

(d) Concentrations of Credit Risk

The Company monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below.

	Cash and Cash Equivalents		**Loans and Receivables**	
	2019	**2018**	**2019**	**2018**
Concentration by sector:				
Financial institutions	133,496,507	93,683,945	0	0
Trading/Commercial	0	0	916,906,992	956,575,689
Manufacturing	0	0	504,461,975	816,992,618
Services	0	0	253,073,787	266,699,706
Others	0	0	1,313,410,546	1,033,013,352
	133,496,507	93,683,945	2,987,853,300	3,073,281,365

**Loans and receivables subjected to credit risk assessments exclude residual value, deferred leasing income, unearned finance income, capitalized interest and other charges, other receivables and allowance for credit and impairment losses.*

The Company maintains a general policy of avoiding excessive exposure in any particular sector of the Philippine economy. The Company actively seeks to increase its exposure in industry sectors, which it believes to possess attractive growth opportunities. Conversely, it actively seeks to reduce its exposure in industry sectors where growth potential is minimal.

4.3 Liquidity Risk

Liquidity risk is the current and prospective risk to earnings or capital arising from the Company's inability to meet its obligations when they become due without incurring unacceptable losses. The Company manages this risk by widening its money market customer base, maintaining adequate credit facilities with banks, and following guidelines set by the BSP on statutory and liquidity reserve policy.

As at December 31, 2019 and 2018, the Company's financial liabilities (except tax-related liabilities) have contractual maturities which are presented below.

	2019			
	One to three months	More than three months to one year	More than one year to three years	Total
Bills payable	636,250,000	588,750,000	2,083,333	1,227,083,333
Accrued expenses and other liabilities	75,089,573	200,000,000	0	275,089,573
Deposit on lease contracts	8,825,740	48,937,101	217,256,900	275,019,741
	720,165,313	837,687,101	219,340,233	1,777,192,647

	2018			
	One to three months	More than three months to one year	More than one year to three years	Total
Bills payable	939,433,836	190,773,105	0	1,130,206,941
Accrued expenses and other liabilities	115,630,594	200,000,000	0	315,630,594
Deposit on lease contracts	43,504,045	42,982,072	177,259,336	263,745,453
	1,098,568,475	433,755,177	177,259,336	1,709,582,988

The contractual maturities reflect the gross cash flows, which may differ from the carrying values of the liabilities at the reporting date.

5. CATEGORIES AND OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

5.1 Carrying Amounts and Fair Values by Category

The carrying amounts and fair values of the categories of financial assets and financial liabilities presented in the statements of financial position, at amortized cost, are shown below.

		2019		2018	
Financial Assets	**Note**	**Carrying Amount**	**Fair Values**	**Carrying Amount**	**Fair Values**
Cash and cash equivalents	7	133,496,507	133,496,507	93,683,945	93,683,945
Loans and receivables	8	2,775,689,688	2,801,505,871	2,681,630,440	3,034,309,365
Refundable deposits	12	918,451	918,451	779,767	779,767
		2,910,104,646	2,935,920,829	2,776,094,152	3,128,773,077
Financial Liabilities					
Bills payable	13	1,227,083,333	1,227,083,333	1,114,166,667	1,114,166,667
Accounts payables and other liabilities	14	275,089,573	275,089,573	315,630,594	315,630,594
Deposit on lease contracts	8	275,019,741	275,019,741	263,745,453	263,745,453
		1,777,192,647	1,777,192,647	1,693,542,714	1,693,542,714

See Notes 2.4 and 2.8 for the description of the accounting policies for each category of financial instruments. A description of the Company's risk management objectives and policies for financial instruments is provided in Note 4.

5.2 Offsetting Financial Assets and Financial Liabilities

The Company has not set-off financial instruments in 2019 and 2018 and does not have relevant offsetting arrangements. Currently, financial assets and financial liabilities are settled on a gross basis; however, each party of the lease agreement will have the option to settle such amount on a net basis in the event of default of the other party. As such, the Company's lease contract receivables from the lessees, net of deferred leasing income and allowance for impairment, amounting to P1.24 billion and P1.02 billion as of December 31, 2019 and 2018, respectively, can be offset by the amount of deposits on lease contracts amounting to P275.02 million and P263.75 million as of December 31, 2019 and 2018, respectively. The balance of lease contract receivables net of deposits on lease contracts amounted to P0.96 billion and P0.76 billion as of December 31, 2019 and 2018, respectively.

6. FAIR VALUE MEASUREMENT AND DISCLOSURE

6.1 Fair Value Hierarchy

In accordance with PFRS 13, *Fair Value Measurement*, the fair value of financial assets and financial liabilities and non-financial assets which are measured at fair value on a recurring or non-recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and,

- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

For purposes of determining the market value at Level 1, a market is regarded as active 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.

For financial assets which do not have quoted market price, the fair value is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Company uses valuation technique, it maximizes the use of observable market data where it is available and relies as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2. Otherwise, it is included in Level 3.

Management considers that the carrying values of financial assets, such as cash and cash equivalents, loans and other receivables and refundable deposits, and financial liabilities such as accounts payables and other liabilities approximates the fair values either because these financial instruments are short-term in nature or the effect of discounting for those with maturities of more than one year is not material.

6.2 Financial Instruments Measured at Amortized Cost for which Fair Value is Disclosed

The table below summarizes the fair value hierarchy of the Company's financial assets and financial liabilities which are not measured at fair value in the statements of financial position but for which fair value is disclosed as of December 31.

			2019	
Financial Assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	133,496,507	0	0	133,496,507
Loans and receivables	0	0	2,801,505,871	2,801,505,871
Refundable deposits	0	0	918,451	918,451
	133,496,507	0	2,802,424,322	2,935,920,829
Financial Liabilities				
Bills payable	0	0	1,227,083,333	1,227,083,333
Accounts payables and other liabilities	0	0	275,089,573	275,089,573
Deposit on lease contracts.	0	0	275,019,741	275,019,741
			1,777,192,647	1,777,192,647

			2018	
Financial Assets	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	93,683,945	0	0	93,683,945
Loans and receivables	0	0	3,034,309,365	3,034,309,365
Refundable deposits	0	0	779,767	779,767
	93,683,945	0	3,035,089,132	3,128,773,077
Financial Liabilities				
Bills payable	0	0	1,114,166,667	1,114,166,667
Accounts payables and other liabilities	0	0	315,630,594	315,630,594
Deposit on lease contracts	0	0	263,745,453	263,745,453
	0	0	1,693,542,714	1,693,542,714

For financial asset with fair values included in Level 1, management considers that the carrying amounts of these instruments approximate their fair values due to their short duration.

The fair values of the financial assets and financial liabilities included in Level 3, which are not traded in an active market, are determined based on the expected cash flows of the underlying asset or liability based on the instrument where the significant inputs required to determine the fair value of such instruments are not based on observable market data.

6.3 Fair Value Measurement of Non-financial Assets

The table below shows the Levels within the hierarchy of assets classified as investment properties and other properties acquired measured at fair value as at December 31.

			2019	
	Level 1	**Level 2**	**Level 3**	**Total**
Investment property:				
Land	0	0	99,158,900	99,158,900
Building	0	0	42,078,000	42,078,000
	0	0	141,236,900	141,236,900
Other properties acquired:				
Machineries and other equipment	0	0	54,527,000	54,527,000
	0	0	195,763,900	195,763,900

			2018	
	Level 1	**Level 2**	**Level 3**	**Total**
Investment property:				
Land	0	0	60,006,000	60,006,000
Building	0	0	40,494,000	40,494,000
	0	0	100,500,000	100,500,000
Other properties acquired:				
Machineries and other equipment	0	0	37,357,000	37,357,000
	0	0	137,857,000	137,857,000

The basis in determining the fair value of the Company's land, and buildings and related improvements classified as Investment Properties and machineries and other equipment classified as Other properties acquired under Other Assets account are based on the appraisals performed by internal appraisers with appropriate qualifications and recent experience in the valuation of similar properties in the relevant locations (see Notes 10 and 12).

To some extent, the valuation process was conducted by the appraiser in discussion with the Company's management with respect to the determination of the inputs such as the size, age, and condition of the land and building and improvements, and the comparable prices in the corresponding property location.

In estimating the fair value of these properties, management takes into account the market participant's ability to generate economic benefits by using the assets in their highest and best use. Based on management assessment, the best use of the Company's non-financial assets indicated above is their current use.

The fair value of these non-financial assets were determined based on the following approaches:

(a) Fair Value Measurement for Land

The fair value of land was derived using market data (direct sales comparison) approach where the value of the land is based on sales and listings of comparable properties registered within the vicinity. The market data approach relies on the comparison of recent sale transactions or offerings of similar properties which have occurred and/or offered with close proximity to the subject property. The technique of this approach requires adjustments to sales and listings by considering the elements of comparison such as real property rights conveyed, conditions of sale, market conditions, location, physical condition and amenities.

(b) Fair Value Measurement of Machineries and Other Equipment

The fair value of the transportation and other equipment was determined based on the appraisal report of independent appraisers. Fair value was determined based on the replacement cost of an asset with an equally satisfactorily substitute asset which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential.

7. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include the following components as at December 31:

	2019	**2018**
Cash in banks	133,488,507	86,328,153
Cash on hand	8,000	8,000
Short-term placements	0	7,347,792
	133,496,507	93,683,945

Cash in banks generally earn interest at rates based on daily bank deposit rates. Short-term placements are made for varying periods from 30 to 90 days and earn effective interest ranging from 1.3 per cent to 1.4 per cent in 2019 and 1.5 per cent to 3.25 per cent in 2018.

In 2019 and 2018, interest income recognized from cash and cash equivalents amounted to P278,026 and P0.59 million, respectively, and is presented as part of Interest Income in the statements of income

8. LOANS AND RECEIVABLES

This account is composed of the following:

	2019	2018
Receivables from customers:		
Lease contracts receivables	1,155,493,975	990,556,557
Residual value of leased properties	268,358,919	234,460,376
Deferred leasing income	(149,387,358)	(125,150,475)
Less: Allowance for credit and impairment losses	(29,532,245)	(76,807,672)
	1,244,933,291	1,023,058,786
Loans receivable	1,009,670,704	693,490,946
Less: Allowance for credit and impairment losses	(53,999,740)	(75,806,275)
	955,670,964	617,684,671
Finance receivables:		
Check discounting	292,624,724	689,586,930
Invoice discounting	296,370,617	473,166,994
Rental discounting	1,984,161	0
Unearned finance income:		
Check discounting	(5,346,488)	(22,178,576)
Invoice discounting	(1,939,411)	(4,670,006)
Rental discounting	(19,275)	0
Less: Allowance for credit and impairment losses	(177,332,826)	(219,227,820)
	406,341,502	916,677,522
Restructured receivables	231,709,118	226,479,938
Residual value of leased properties under restructured receivables	4,174,222	22,240,943
Capitalized interest and other charges	(17,316,327)	(20,428,025)
Less: Allowance for credit and impairment losses	(68,702,902)	(121,816,653)
	149,864,111	106,476,203
Other receivables:		
Sales contracts receivable	8,007,367	9,550,010
Accounts receivable	5,624,664	3,105,837
Accrued interest receivable	3,100,360	2,143,004
Others	3,692,088	3,647,199
Less: Allowance for credit and impairment losses	(1,544,659)	(712,792)
	18,879,820	17,733,258
	2,775,689,688	2,681,630,440

Lease contracts receivable are due in monthly installments with terms ranging from one to five years. These are broken down as follows:

	2019	2018
Lease contracts receivable:		
Due within one year	87,367,880	93,248,031
Due beyond one year but not beyond five years	1,068,126,095	897,308,526
	1,155,493,975	990,556,557
Residual value of leased properties:		
Due within one year	55,413,240	62,308,640
Due beyond one year but not beyond five years	212,945,679	172,151,736
	268,358,919	234,460,376
Gross investment in lease contract receivable	1,423,852,894	1,225,016,933
Less: Deferred leasing income	(149,387,358)	(125,150,475)
Net investment in lease contracts receivable	1,274,465,536	1,099,866,458

The net investment in lease contracts receivable by contractual maturity dates are analyzed as follows:

	2019	2018
Due within one year	139,011,981	150,728,643
Due beyond one year but not beyond five years	1,135,453,555	949,137,815
	1,274,465,536	1,099,866,458

As at December 31, 2019 and 2018, residual value of leased properties amounting to P272.53 million and P256.70 million, respectively, pertains to the estimated proceeds from the disposals of the leased asset at the end of the lease term, which approximates the amount of guaranty deposit paid by the lessee at the inception of the lease as presented in Deposit on Lease Contracts in the statements of financial position. At the end of the lease term, the lessee may apply this deposit as payment for the residual value of the property.

Lease contracts receivable earn annual interest at rates ranging from 7 per cent to 13.50 per cent and 7 per cent to 18.00 per cent in 2019 and 2018, respectively. The Company recognized interest income from lease contracts receivable amounting to P89.76 million and P75.73 million in 2019 and 2018, respectively, and is presented as Leasing Income under Revenues in the statements of income.

Loans receivable are secured commercial loans extended by the Company for financing acquisitions of properties and equipment. Loans receivable earn annual interest rates ranging from 7 per cent to 15 per cent and 7 per cent to 16 per cent in 2019 and 2018, respectively.

Loans receivable by contractual maturity dates is analyzed as follows:

	2019	2018
Due within one year	17,880,705	68,450,485
Due beyond one year but not beyond five years	991,789,999	625,040,461
	1,009,670,704	693,490,946

Restructured receivables earn annual interest at rates ranging from 7 per cent to 12 per cent and 7.25 per cent to 11 per cent in 2019 and 2018, respectively.

The breakdown of the Company's interest income follows:

	Note	2019	2018
Finance receivables		62,037,292	95,414,541
Loans receivable		81,528,879	61,107,607
Restructured receivables		14,949,853	8,111,764
Sales contract receivable		1,101,786	1,186,600
Cash in banks	5	278,026	587,174
		159,895,836	166,407,686

As at December 31, 2019 and 2018, non-performing loans (NPLs) not fully covered by allowance for credit losses amounted to P493.34 million and P463.73 million, respectively.

As at December 31, 2019 and 2018, secured and unsecured NPLs follow:

	2019	2018
Secured	223,914,930	302,892,578
Unsecured	269,424,330	160,836,630
	493,339,260	463,729,208

Generally, NPLs refer to loans whose principal and/or interest is unpaid for thirty days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered non-performing.

In the case of receivables that are payable in monthly installments, the total outstanding balance thereof shall be considered non-performing when three or more installments are in arrears. In the case of receivables that are payable in weekly, or semi-monthly installments, the total outstanding balance thereof shall be considered non-performing at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the receivable shall be considered as past due when the total amount of arrearages reaches more than 10 per cent of the total receivable balance.

A loan which is restructured shall be considered non-performing except when as of restructuring date:

(1) with updated principal and interest payments; and,

(2) fully secured by real estate with loan value of up to 60 per cent of the appraised value of the real estate security and the insured improvements thereon, and such other first-class collaterals as may be deemed appropriate by the Monetary Board. Provided, that a restructured loan, with or without capitalized interest, must be yielding a rate of interest equal to or greater than the Company's average cost of funds at the date of restructuring, otherwise, it shall be considered non-performing.

The restoration to a performing loan shall only be effective after a satisfactory track record of payments of the required amortizations of principal and/or interest has been established.

For this purpose, a satisfactory track record of payments of principal and/or interest shall mean three consecutive payments of the required amortizations of principal and/or interest have been made.

However, in the case of a restructured loan with capitalized interest but not fully secured by real estate with loan value of up to 60 per cent of the appraised value of the real estate security and the insured improvements thereon or other first class collaterals, six consecutive payments of the required amortizations of principal and/or interest must have been made.

A restructured loan which has been restored to a performing loan status shall be immediately considered non-performing in case of default of any principal or interest payment.

A reconciliation of the allowance for credit losses for loans and receivables by class follows:

	Lease Contract Receivables	Loans Receivables	Finance Receivables	Restructured Receivables	Other Receivables	Total
At January 1, 2019	76,807,672	75,806,275	219,227,820	121,816,653	712,792	494,371,212
Losses (reversals)	0	0	0	16,520,113	442,931	16,963,044
Reclassifications/ reallocation	(17,766,417)	(5,971,517)	52,777,822	(25,086,837)	388,936	4,341,987
Write-off	(29,509,010)	(15,835,018)	(94,672,816)	(44,547,027)	0	(184,563,871)
At December 31, 2019	29,532,245	53,999,740	177,332,826	68,702,902	1,544,659	331,112,372
At January 1, 2018						
As previously reported	38,522,613	11,830,592	76,003,125	46,151,118	675,893	173,183,341
Effect of adoption of PFRS 9	83,950,919	64,311,384	132,179,711	74,614,191	0	355,056,205
As restated	122,473,532	76,141,976	208,182,836	120,765,309	675,893	528,239,546
Losses (reversals)	(14,739,891)	(1,255,192)	69,429,772	22,066,256	33,008	75,533,953
Reclassifications/ reallocation	443,546	2,159,740	(2,484,423)	(9,506,424)	3,891	(9,383,670)
Write-off	(31,369,515)	(1,240,249)	(55,900,365)	(11,508,488)	0	(100,018,617)
At December 31, 2018	76,807,672	75,806,275	219,227,820	121,816,653	712,792	494,371,212

With the foregoing level of allowance for credit losses, management believes that the Company has sufficient allowance to cover significant losses that may be incurred from the non-collection or non-realization of its loans and receivables.

9. INVESTMENT IN A SUBSIDIARY

Investment in a subsidiary pertains to investment in UFEC, a wholly owned subsidiary of the Company, with a carrying amount of P5.69 million and P5.38 million at December 31, 2019 and 2018, respectively, which is accounted for at equity method.

BSP has regulated the foreign exchange market which resulted to stringent regulations affecting the business operations of foreign exchange corporations that led to the suspension of the UFEC's commercial operations in 2004. UFEC had an initial plan to terminate its corporate life on December 31, 2006. However, UFEC has decided to put on hold its dissolution plans. The decision to resume UFEC's operation will depend largely on the policy direction the regulators would take in the succeeding years.

The movements in the carrying amount of investment in a subsidiary as of December 31, which is accounted for under the equity method, is shown below.

	2019	2018
Cost	4,025,000	4,025,000
Accumulated share in net profit:		
Balance at beginning of the year	1,292,928	1,125,724
Share in net profit	168,528	167,204
Balance at end of the year	1,461,456	1,292,928

	2019	2018
Accumulated share in other comprehensive income:		
Balance at beginning of the year	63,000	490,500
Share in other comprehensive income	138,000	(427,500)
Balance at end of the year	201,000	63,000
Carrying amount of investment	5,687,456	5,380,928

10. INVESTMENT PROPERTIES

The Company's investment properties include buildings and several parcels of land, which are held for investment purposes only and not for sale within 12 months from the end of the reporting period nor used in the Company's daily operations. Real estate tax on investment property for each year was recognized as a related expense in 2019 and 2018. There was no income recognized related to these assets in 2019 and 2018.

The carrying amounts of investment properties presented in the statements of financial position as at December 31, 2019 and 2018 are shown below.

	2019	2018
Cost	86,887,040	95,151,120
Accumulated depreciation	(3,594,102)	(1,569,402)
Accumulated impairment	(3,396,716)	(9,691,008)
Net carrying amount	**79,896,222**	**83,890,710**

A reconciliation of the carrying amounts of investment properties at the beginning and end of 2019 and 2018 is shown below.

	2019	2018
Balance at beginning of the year	83,890,710	91,370,583
Additions	1,584,000	422,484
Reallocation of impairment	4,732,012	1,230,759
Depreciation	(2,024,700)	(1,451,555)
Disposals	(8,285,800)	(7,681,561)
Balance at end of the year	**79,896,222**	**83,890,710**

The aggregate appraised values of the investment properties as at December 31, 2019 and 2018 are P141.24 million and P100.50 million, respectively. Other information about the fair value measurement and disclosures related to the investment properties are presented in Note 6.3.

Fair values which are market values for land and building and related improvements and reproduction cost for certain building and improvements have been determined based on valuations made by in-house and independent professional appraisers. Valuations were derived on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made.

Gain on sale of investment properties amounted to P1.26 million and P2.06 million in 2019 and 2018, respectively, and is presented as part of Gain on sale of assets acquired under the Other Income account in the statements of income (see Note 17.1).

11. PROPERTY AND EQUIPMENT

The gross carrying amounts and accumulated depreciation and amortization of property and equipment at the beginning and end of 2019 and 2018 are shown below:

	Furniture, Fixtures and Office Equipment	Transportation Equipment	Leasehold Improvement	Right of Use Asset	Total
December 31, 2019					
Cost	6,556,153	4,219,178	8,475,908	16,640,579	35,891,818
Accumulated Depreciation and amortization	(4,883,468)	(2,306,175)	(2,347,463)	0	(9,537,106)
Net Carrying Amount	1,672,685	1,913,003	6,128,445	16,640,579	26,354,712

	Furniture, Fixtures and Office Equipment	Transportation Equipment	Leasehold Improvement	Right of Use Asset	Total
December 31, 2018					
Cost	8,305,731	4,136,303	8,475,907	0	20,917,941
Accumulated Depreciation and amortization	(5,985,974)	(1,525,701)	(1,163,833)	0	(8,675,508)
Net Carrying Amount	2,319,757	2,610,602	7,312,074	0	12,242,433
January 1, 2018					
Cost	7,600,473	5,416,136	8,270,421	0	21,287,030
Accumulated Depreciation and amortization	(5,190,941)	(2,258,882)	(720,644)	0	(8,170,467)
Net Carrying Amount	2,409,532	3,157,254	7,549,777	0	13,116,563

A reconciliation of the carrying amounts of property and equipment at the beginning and end of 2019 and 2018 is shown below:

	Furniture, Fixtures and Office Equipment	Transportation Equipment	Leasehold Improvement	Right of Use Asset	Total
Balance at January 1, 2019 net of accumulated depreciation and amortization	2,319,757	2,610,602	7,312,074	23,011,986	35,254,419
Additions	535,346	928,065	0	0	1,463,411
Disposal		(1,039,846)	0	0	(1,039,846)
Reclassification	(403,455)	223,999	0	0	(179,457)
Depreciation and amortization charges for the year	(778,963)	(809,817)	(1,183,629)	(6,371,406)	(9,143,815)

	Furniture, Fixtures and Office Equipment	Transportation Equipment	Leasehold Improvement	Right of Use Asset	Total
Balance at December 31, 2019 net of accumulated depreciation and amortization	**1,672,685**	**1,913,003**	**6,128,445**	**16,640,579**	**26,354,712**
Balance at January 1, 2018 net of accumulated depreciation and amortization	2,409,532	3,157,254	7,549,777	0	13,116,563
Additions	705,258	805,001	0	0	1,510,259
Disposal	0	(315,434)	223,999	0	(91,435)
Reclassification	0	(223,999)	(18,513)	0	(242,512)
Depreciation and amortization charges for the year	(795,033)	(812,220)	(443,189)	0	(2,050,442)
Balance at December 31, 2018 net of accumulated depreciation and amortization	**2,319,757**	**2,610,602**	**7,312,074**	**0**	**12,242,433**

12. OTHER ASSETS

This account consists of:

	Note	2019	2018
Other properties acquired – net	12.1	33,938,803	32,179,036
Prepaid expenses		9,629,113	6,736,106
Refundable deposits		918,451	779,767
Others		5,983,009	2,201,590
		50,469,376	**41,896,499**

12.1 Other Properties Acquired

The movements of other properties acquired are presented below.

	Note	2019	2018
Cost			
Balance at beginning of year		61,156,220	90,438,847
Additions		10,730,000	16,037,000
Disposal		(3,100,000)	(45,319,627)
Balance at the end of year		**68,786,220**	**61,156,220**

	Note	2019	2018
Accumulated Depreciation			
Balance at the beginning of year		20,897,958	21,245,401
Depreciation during the year	17.2	11,186,592	12,451,886
Disposal		(1,028,666)	(12,799,329)
Balance at the end of year		**31,055,884**	**20,897,958**
Allowance for Impairment Losses			
Balance at the beginning of year		8,079,226	4,706,401
Reallocation		(4,287,693)	7,902,256
Impairment during the year	17.2	0	28,971
Disposal		0	(4,558,402)
Balance at the end of year		**3,791,533**	**8,079,226**
		33,938,803	**32,179,036**

In 2019 and 2018, the Company recognized net gain on foreclosure of other properties acquired amounting to P5.13 million and P2.32 million, respectively, and presented under Gain (loss) on foreclosure under the Other Income account in the statements of income (see Note 17.1).

In addition, the Company incurred a loss on sale of other properties acquired amounting to P1.26 million and P P7.33 million in 2019 and 2018, respectively, and is presented as part of Gain (loss) on sale of assets acquired under the Other Income account in the statements of income (see Note 17.1).

The aggregate appraised values of other properties acquired as of December 31, 2019 and 2018 are P54.53 million and P37.36 million, respectively. Other information about the fair value measurement and disclosures related to other properties acquired are presented in Note 6.3.

13. BILLS PAYABLE

This account consists of borrowings from various banks which are unsecured in nature, have contractual maturities ranging from one month to three years.

The Company pays annual interest rates ranging from 5.85 per cent to 7.50 per cent in 2019 and 5.15 per cent to 7.25 per cent in 2018. Interest expense from bills payable amounted to P80.67 million and P P71.58 million in 2019 and 2018, respectively, and is presented as Interest Expense in the statements of income. Interest which remained unpaid as of December 31, 2019 and 2018 amounted to P2.45 million and P2.39 million, respectively, and is presented as Accrued interest on bills payable under the Accounts Payables and Other Liabilities account in the statements of financial position (see Note 14).

14. ACCOUNTS PAYABLES AND OTHER LIABILITIES

This account consists of the following as of December 31:

	Note	2019	2018
Dividends payable	16.3	200,000,000	200,000,000
Accounts payable		60,019,039	105,887,862
Accrued taxes and licenses		3,719,735	5,780,229
Withholding tax payable		1,436,421	3,756,074
Accrued interest on bills payable	13	2,454,767	2,391,610
Accrued other expenses		1,500,495	7,351,122
Lease liability		15,887,457	0
		285,017,914	**325,166,897**

Accounts payable consists of unreleased checks to suppliers of properties leased by borrowers and advances from customers received upon availment of a loan or lease contract which are used for notarial fees, appraisal fees, registration fees and other related expenses.

Accrued other expenses include management and other professional fees, rent and other expenses.

Lease liability was measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate as of January 1, 2019.The average incremental borrowing rate applied to the lease liability was 7.00 per cent.

The undiscounted maturity analysis of lease liabilities as at December 31, 2019 is as follows:

	Within 1 year	Two to Five years	Total
Lease Payments	8,146,693	10,958,607	19,105,300
Finance Charges	(1,032,036)	(2,185,807)	(3,217,843)
Net Present Value	**7,114,657**	**8,772,800**	**15,887,457**

15. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analyzed according to when they are expected to be recovered or settled.

	2019			2018		
	Within One Year	**Beyond One Year**	**Total**	**Within One Year**	**Beyond One Year**	**Total**
Financial Assets						
Cash and cash equivalents	133,496,507	0	133,496,507	93,683,945	0	93,683,945
Loans and receivables – gross	762,232,338	2,344,569,722	3,106,802,060	1,268,872,787	1,907,128,865	3,176,001,652
Refundable deposits	0	918,451	918,451	0	779,767	779,767
	895,728,845	2,345,488,173	3,241,217,018	1,362,556,732	1,907,908,632	3,270,465,364
Allowance for credit and impairment losses	(204,880,332)	(126,232,040)	(331,112,372)	(330,993,487)	(163,377,725)	(494,371,212)
	690,848,513	2,219,256,133	2,910,104,646	1,031,563,245	1,744,530,907	2,776,094,152

	2019			2018		
	Within One Year	Beyond One Year	Total	Within One Year	Beyond One Year	Total
Financial Assets Non-Financial Assets						
Investment in a subsidiary - net	0	5,687,456	5,687,456	0	5,380,928	5,380,928
Investment properties – net	0	79,896,222	79,896,222	0	83,890,710	83,890,710
Deferred tax assets – net	0	129,423,212	129,423,212	0	153,078,515	153,078,515
Property and equipment – net	0	26,354,712	26,354,712	0	12,242,433	12,242,433
Other assets - net	15,612,087	33,938,803	49,550,890	8,937,696	32,179,036	41,116,732
	15,612,087	275,300,405	290,912,492	8,937,696	286,771,622	295,709,318
	706,460,600	2,494,556,538	3,201,017,138	1,040,500,941	2,031,302,529	3,071,803,470
Financial Liabilities						
Bills Payable	1,225,000,000	2,083,333	1,227,083,333	1,114,166,667	0	1,114,166,667
Accounts payable and other liabilities	279,861,758	0	279,861,758	315,630,594	0	315,630,594
Deposits on lease contracts	57,762,842	217,256,899	275,019,741	86,486,117	177,259,336	263,745,453
	1,562,624,600	219,340,232	1,781,964,832	1,516,283,378	177,259,336	1,693,542,714
Non-Financial Liabilities						
Other Liabilities	5,156,156	0	5,156,156	9,536,303	0	9,536,303
	1,567,780,756	219,340,232	1,787,120,988	1,525,819,681	177,259,336	1,703,079,017

16. EQUITY

16.1 Capital Management Objectives, Policies and Procedures

The Company's capital management objectives are to provide an adequate return to the stockholders and to ensure the Company's ability to continue as a going concern by pricing products and services commensurately with the level of risk.

The Company monitors capital on the basis of the carrying amount of equity as presented in the statements of financial position. Capital for the reporting periods under review is summarized as follows:

	2019	2018
Total liabilities	1,787,120,988	1,703,079,017
Total equity	1,413,896,185	1,368,724,453
Debt-to-equity ratio	**1.26:1.00**	**1.24:1.00**

The Company sets the amount of capital in proportion to its overall financing structure, i.e., equity and total liabilities. The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, issue new shares or sell assets to reduce debt.

The Company is subject to an externally imposed capital requirement of a minimum of P10 million paid-up capital [see Note 20.1(a)]. The Company's paid-up capital as of December 31, 2019 and 2018 amounted to P775 million, which amount is in excess of the externally imposed capital requirement (see Note 16.2).

16.2 Capital Stock

Capital stock as of December 31, 2019 and 2018 consists of:

	Shares	Amount
Common shares – P100 par value		
Authorized – 10,000,000 shares		
Issued and outstanding	7,750,000	775,000,000

As of December 31, 2019 and 2018, the Company has only one stockholder owning 100 or more shares of the Company's capital stock.

16.3 Retained Earnings

In compliance with the requirements of the BSP, the Company appropriated P22.17 million for general loan loss provision to meet the one per cent minimum provisions on loans (see Note 2.17) and is presented as part of Appropriated Retained Earnings account.

On December 15, 2017, the BOD approved the declaration of cash dividends amounting to P200 million out of unappropriated retained earnings, which is payable to all stockholders of record as of December 31, 2017 and to be paid on December 31, 2019 (see Note 14).

On December 15, 2017, the BOD approved the appropriation of P100 million from the Company's earnings for stock dividend declaration purposes, and to address the excess projected unappropriated retained earnings over paid up capital.

The details of the prior period adjustments presented in the Statement of Changes in Equity in 2019 is as follows:

Adjustment of MCIT in prior years previously recognized in expense to Deferred tax assets	2,210,154
Recharged Cerquit accounting system maintenance to Intangible asset	367,600
Adjustment of interests on bank deposits in prior years	(250,559)
Reclassification of issued small tangible assets from property and equipment to expense	(16)
Prior period adjustments	**2,327,179**

17. OTHER INCOME AND OPERATING EXPENSES

17.1 Other Income

This account consists of:

	Note	2019	2018
Gain on sale of receivables	18.2	2,992,378	11,597,333
Service charges and penalties		6,470,568	9,736,762
Gain on foreclosure	12.1	5,131,432	2,315,525

	Note	2019	2018
Loss on sale of assets acquired		(4,134)	(5,275,823)
Rental-Real Property and Equipment		1,255,775	0
Miscellaneous		5,692,307	4,947,804
		21,538,326	**23,321,601**

17.2 Other Operating Expenses

The details of other operating expenses are shown below.

	Note	2019	2018
Impairment and credit losses	8, 10, 12.1	16,963,044	75,562,924
Salaries and employee benefits		39,710,379	48,717,708
Taxes and licenses	19, 23.e	25,958,299	27,286,229
Depreciation and amortization	10, 11, 12.1	22,355,108	15,953,883
Occupancy	18.3, 21.1	1,836,403	11,219,613
Litigation and others legal expenses		4,903,633	5,218,338
Communication and utilities		3,055,261	3,896,425
Management and professional fees		449,255	786,950
Representation and entertainment		187,332	515,541
Miscellaneous expense		3,671,979	3,890,124
		119,090,693	**193,047,735**

18. RELATED PARTY TRANSACTIONS

The Company, in the normal course of business, has various transactions with the parent bank, and key management personnel which consist mainly of deposit arrangements, loans and advances, short-term borrowings, and management service agreements.

The amounts of these transactions and outstanding balances as of and for the years ended December 31, 2019 and 2018 are presented below.

		2019		2018	
Related Party Category	**Note**	**Amount of Transaction**	**Outstanding Balance**	**Amount of Transaction**	**Outstanding Balance**
Parent Bank					
Cash in bank	18.1	46,287,373	116,280,842	7,644,057	71,229,023
Sale of receivables	18.2	250,098,052		730,851,206	
Occupancy cost	18.3			5,813,497	
Key Management Personnel					
Compensation	18.4	12,396,440		12,128,282	

18.1 Cash in Bank

The Company's cash in banks include deposit account with the Parent Bank, which generally earn interest based on the daily bank deposit rates (see Note 7).

18.2 Sale of Receivables

In 2019 and 2018, the Company sold finance receivable and lease contract receivables and other loan receivables on a without recourse basis amounting to P250.10 million and P730.85 million, respectively, to the Parent Bank. The recognized gain on such sale amounted to P3.00 million and P11.60 million in 2019 and 2018, respectively, and is presented as Gain on sale of receivables under Other Income account in the statements of income (see Note 17.1).

18.3 Lease Agreement

The Company has existing agreement with the Parent Bank for the lease of its office space which are renewable every two to three years at the Company's option. Under the terms of the lease agreement, the Company is required to pay rentals equivalent to a fixed rate per square meter occupied.

Right-of-use assets and lease liabilities related to the lease agreement have been presented separately from property, plant and equipment and other liabilities, respectively.

18.4 Key Management Personnel Compensation

Salaries and other benefits received by key management personnel is broken down as follows:

	2019	**2018**
Salaries	12,396,440	11,826,082
Others short-term benefits	0	302,200
	12,396,440	**12,128,282**

19. TAXES

The components of tax expense as reported in the statements of income for the years ended December 31 are as follows:

	2019	**2018**
Current tax expense:		
Minimum corporate income tax (MCIT)	0	2,210,154
Regular corporate income tax (RCIT)	0	
Final tax at 20 per cent	50,087	111,322
	50,087	2,321,476
Deferred tax expense (income) relating temporary differences	28,352,153	(21,655,561)
	28,402,240	**(19,334,085)**

A reconciliation of tax on pretax profit computed at the applicable statutory rates to tax expense reported in profit or loss section of the statements of income follows:

	2019	**2018**
Tax on pretax profit at 30 per cent	21,332,638	301,055
Adjustment for income subjected to lower income tax rates	(33,320)	(64,830)
Tax effects of:		
Net operating loss carry-over (NOLCO)	(37,236,864)	(17,047,987)
Loss on sale of assets acquired	(1,465,772)	(6,189,537)
Non-deductible interest and other expenses	29,024	2,447,666

	2019	2018
Unrecognized MCIT	-	2,210,154
Net deferred tax adjustment	45,827,092	(940,445)
Non-taxable income	(50,558)	(50,161)
	28,402,240	**(19,334,085)**

The net deferred tax assets relate to the following as of December 31:

	Statement of Financial Position		**Statement of Comprehensive Income**	
	2019	**2018**	**2019**	**2018**
Deferred tax assets:				
Allowance for impairment	101,490,186	153,642,434	52,152,248	10,335,337
NOLCO	54,284,851	17,047,987	(37,236,864)	(17,047,987)
Accumulated depreciation on other properties acquired	10,394,996	6,740,208	(3,654,788)	(331,233)
Minimum Corporate Income Tax	4,696,849	0	0	0
Deferred tax liabilities:				
Lease income differential operating lease method	(39,904,240)	(23,657,456)	16,246,784	(2,877,518)
Unrealized gain on foreclosed assets	(1,539,430)	(694,658)	844,773	(11,734,160)
Deferred tax assets – net	**129,423,212**	**153,078,515**		
Deferred tax expense			**28,352,153**	**(21,655,561)**

The Company is subject to MCIT, which is computed at two per cent of gross income, as defined under tax regulations or RCIT, whichever is higher.

In 2019 and 2018, the Company claimed itemized deductions in computing for income tax due.

20. COMPLIANCE WITH REPUBLIC ACT NO. 8556, THE FINANCING COMPANY ACT OF 1998

The Company, which was organized for the purpose of extending credit facilities to consumers by direct lending, is governed by the R.A. No. 8556. Presented in the succeeding page are the significant provisions under R.A. No. 8556 that are applicable to the Company.

20.1 *Form of Organization*

Under Section 2 of R.A. No. 8556, financing companies shall be organized in a form of Stock Corporation in accordance with the provisions of the Code, subject to the following:

(a) As of December 31, 2019 and 2018, the Company is a wholly owned subsidiary of a universal bank incorporated and domiciled in the Philippines.

A minimum paid-up capital of P10 million for financing companies located in Metro Manila and other 1st class cities and additional capital of P1 million for branches established in Metro Manila, P500,000 for branches in other classes of cities and P250,000 for branches established in municipalities. The Company is in compliance with the minimum paid-up capital requirement as of December 31, 2019 and 2018 (see Note 16.2).

(b) The corporate name of financing companies shall contain the term "financing company" or other title or word(s) descriptive of its operations and activities as a financing company (see Note 1).

20.2 Licensing Fees

Under Section 8 of R.A. No. 8556, an annual fee amounting to P10, 000.00 for offices in Metro Manila shall be charged and the same shall be paid not later than 45 days before the anniversary date of the Certificate of Authority to Operate as a Financing Company and for as long as its license to operate is in effect.

The Company's licensing fees for the years ended December 31, 2019 and 2018 are presented as part of Taxes and licenses under the Other Operating Expenses account in the statements of income (see Note 17.2).

20.3 Loans and Investments

The following are the provisions under Section 9 of the R.A. No. 8556:

(a) The total investment of a financing company in real estate and in shares of stock in a real estate development corporation and other real estate based projects shall not at any time exceed 25 per cent of its net worth.

As of December 31, 2019 and 2018, the Company has no investment in real estate.

(b) More than 50 per cent of the funds of a financing company shall be used or invested in financing company activities; provided, that in the computation of the amount of funds used or invested in financing company activities, investments in government securities with maturity not more than one year and special savings deposits shall be taken into consideration.

For the years ended December 31, 2019 and 2018, the Company obtained loans for working capital purposes (see Note 13).

(c) The total credit that a financing company may extend to its directors, officers and stockholders shall not exceed 15 per cent of its net worth.

As of December 31, 2019 and 2018, the Company has no outstanding loans receivables from its directors, officers, stockholders and other related parties.

(d) The total credit that a financing company may extend to any person, company, corporation or firm shall not exceed 30 per cent of its net worth.

As of December 31, 2019 and 2018, the Company did not extend any credit that exceeded 30 per cent of its net worth.

(e) Unless collected, interest income shall not be recognized on loans receivables that remain outstanding beyond maturity dates.

The Company is in compliance of this provision as it recognizes interest income earned from loan date up to its maturity and the Company ceases to recognize interest in case when the loan becomes past due.

21. COMMITMENTS AND CONTINGENCIES

21.1 Lease Commitments in 2018 – Company as Lessee

The Company is a lessee under various operating leases covering certain warehouse. These leases have terms of one to five years, with renewal options. Rent expense arising from these leases amounted to P11.22 million in 2018 which is presented as Occupancy under Other Operating Expenses account in the statements of income (see Note 17.2).

Future minimum rental payments under these operating lease contracts as of December 31, 2018 are as follows:

	2018
Within one year	8,198,601
More than one year but less than five years	20,722,926
	28,921,527

21.2 Legal Claims and Other Commitments

As of December 31, 2019 and 2018, there are pending claims and legal actions against or in favor of the Company arising from the normal course of business. In addition, there are other commitments and contingencies that arise in the normal course of the Company's operations which are not reflected in the accompanying financial statements. Management is of the opinion that, as of December 31, 2019 and 2018, losses, if any, that may arise from all of the above commitments and contingencies will not have a material effect on the Company's financial statements.

22. RECONCILIATION OF LIABILITIES ARISING FROM FINANCING ACTIVITIES

Presented below is the reconciliation of the Company's liabilities arising from financing activities, which includes both cash and non-cash changes.

	Bills Payable (Note 13)	**Dividends Payable (Note 14)**	**Total**
Balance as of January 1, 2019	1,114,166,667	200,000,000	1,314,166,667
Cash flows from financing activities			
Proceeds from availment of bills payable	2,690,000,000	0	2,690,000,000
Repayment of bills payable	(2,577,083,334)	0	(2,577,083,334)

	Bills Payable (Note 13)	Dividends Payable (Note 14)	Total
Dividends declared	0	0	0
Balance as of December 31, 2019	**1,227,083,333**	**200,000,000**	**1,427,083,333**

23. SUPPLEMENTAL INFORMATION REQUIRED BY THE BUREAU OF INTERNAL REVENUE

Presented below and in the succeeding pages is the supplementary information which is required by the Bureau of Internal Revenue (BIR) Revenue Regulation (RR) No. 15-2010 to disclosed as part of the notes to financial statements. This supplementary information is not a required disclosure under PFRS.

The information on taxes, duties and license fees paid or accrued during the taxable year required under RR No. 15-2010 are presented below and in the succeeding pages.

(a) Gross Receipts Tax

In lieu of the value-added tax, the Company is subject to the gross receipts tax (GRT) imposed on all banks and non-bank financial intermediaries performing quasi-banking functions pursuant to Section 121 of the Tax Code, as amended. Total GRT reported as a component of the Taxes and licenses under Other Operating Expenses account (see Note 23.e) is broken down as follows:

Taxable Transactions	Tax Base	GRT
Interest, commissions and discounts period of five years or less – 5%	238,016,979	11,900,849
Interest, commissions and discounts period of more than 5 years – 1%	11,289,569	112,896
All other items treated as gross income – 5%	17,679,797	883,990
	266,986,345	**12,897,735**

(b) Excise Tax

The Company did not pay excise tax in 2019 since it did not have any transactions which are subject to excise tax.

(c) Taxes on Importation

The Company did not pay any customs' duties and tariff fees to the Bureau of Customs since it did not have any importations during the year.

(d) Documentary Stamp Tax (DST)

For the year ended December 31, 2019, DST paid and accrued amounting to P8.29 million refers to original issue of debt instruments and shares of stocks. The amount of DST paid and recognized during the year is recorded as part of Taxes and licenses under Other Operating Expenses account in 2019 statement of income.

(e) Taxes and Licenses

The details of Taxes and licenses under Other Operating Expenses account in 2019 are as follows (see Note 17.2):

	Note	
GRT	23.a	12,897,735
Documentary stamps	23.d	8,289,738
Fringe benefit tax		4,079,570
Others		691,257
		25,958,300

(f) Withholding Taxes

The details of total withholding taxes for the year ended December 31, 2019 are shown below:

Expanded	624,567
Other percentage tax	375,379
Value-added tax	436,475
	1,436,421

The Company did not have any transaction subject to final and compensation withholding taxes for the year ended December 31, 2019.

(g) Deficiency Tax Assessment and Tax Cases

As of December 31, 2019, the Company does not have any final deficiency tax assessments from the BIR or tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open taxable years.

24. OTHER SUPPLEMENTARY INFORMATION

A. In compliance with the Revised Securities Regulation Rule 68 issued by the Securities and Exchange Commission, the following are the financial soundness indicators of the Company:

	2019	**2018**
Current Ratio	.45	.68
(Cash + Loans and receivables + Trading securities)	706,460,600	1,040,500,941
Total current liabilities	1,567,780,756	1,525,819,681
Debt-to-equity ratio	1.26	1.24
Total liabilities	1,787,120,988	1,703,079,017
Total equity	1,413,896,185	1,368,724,453
Return on equity	0.03	0.01
Net profit	42,706,553	20,337,603
Average equity	1,413,896,185	1,368,724,453
Return on assets	0.01	0.01
Net profit	42,706,553	20,337,603
Average assets	3,201,017,173	3,071,803,470
	0.87	0.87

	2019	2018
Loans to Assets		
Total loans and other receivables	2,775,689,688	2,681,630,440
Total assets	3,201,017,173	3,071,803,470

B. In compliance with the BSP Circular No. 1075, the following are basic quantitative indicators of financial performance of the Company in addition to the financial soundness indicators presented in the previous table:

	2019	2018
Net interest margin	5%	5%
CAR	34%	38%

PART II

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATIONS AND RECOMMENDATIONS

A. FINANCIAL AUDIT

1. **The ULFC reported P472.937 million or 15.77 per cent past due loans and receivables which is beyond the approved past due target of 12 per cent for CY 2019 and may impact on the fund support of programs, activities and projects of the Company.**

1.1 The Policy Statement and Item A.1 of the Guidelines and Procedures in Implementing Curing Period for Past Due Accounts approved on August 30, 2019 provides that:

> *As a general rule, loans, investments, receivables, or any financial asset, including restructured loans, shall be considered past due when any principal and/or interest or installment due or portions thereof, are not paid at their contractual due date, in which case, the total outstanding balance thereof shall be considered as past due.*
>
> *A.1 Accounts shall be considered past due in accordance with the rules and regulations of Bangko Sentral ng Pilipinas (BSP) under Subsection X306.1 of the Manual of Regulations for Banks (MORB as amended by BSP Circular No. 941), as follows:*

Mode of Payment	*Considered Past Due*	*Maximum Cure Period*
Monthly/Quarterly/ Semestrally/Annual	*One (1) calendar day after due date excluding cure period, if any*	*Not more than thirty (30) calendar days*

1.2 As a wholly-owned subsidiary of the UCPB, the final and approved business targets of the ULFC was included in the Revised Three-Year Business Plan approved by the Parent Bank's Board of Directors in a Special Meeting held on August 29, 2019 thru Resolution No. 421A-2019 (Second Amended 3-Year Business Plan). The strategies and action plans include improving the ULFC Portfolio's credit quality by aiming to bring down past due ratio to 15 per cent by the end of 2018, 12 per cent by 2019 and maintain a single-digit past due from 2020 onwards via:

a. Intensified collection and repossession efforts;

b. Immediate restructuring of accounts whose businesses remain viable; and

c. Write-off of accounts whose recovery hopes have dimmed.

1.3 As at December 31, 2019, the ULFC reported a total of P2.999 billion of Loans and receivables (LR) excluding Items under Litigation. Based on the following Schedule of Aging, the past due accounts amounted to P472.937 million or 15.77 per cent of the total loans and receivables which is more than the 12 per cent target of the Company for CY 2019, to wit:

Particulars	Lease contract receivables	Other loans and receivables	Finance and factoring receivables	Restructured loans	Sales contract receivables	Accounts receivables	Total
Current	P1,093,683,405	P 920,794,110	P376,545,951	P124,824,766	P7,201,899	P2,668,455	P2,525,718,586
Past due							
Over 1 month	8,925,216	29,122,425	1,813,822	20,250,087	576,693	1,200	60,689,443
Over 2 months	0	7,037,178	8,942,474	2,776,803	0	6,990	18,763,445
Over 3 months	0	33,888,583	25,303,829	0	228,775	8,920	59,430,107
Over 6 months	0	0	90,430,762	52,415,662	0	871,479	143,717,903
Over 1 year	52,885,295	18,828,395	87,942,557	28,612,445	0	2,067,620	190,336,312
Sub-total	**61,810,511**	**88,876,581**	**214,433,444**	**104,054,997**	**805,468**	**2,956,209**	**472,937,210**
Total	**P1,155,493,916**	**P1,009,670,691**	**P590,979,395**	**P228,879,763**	**P8,007,367**	**P5,624,664**	**P2,998,655,796**
% Past due over Total	**5.35%**	**8.80%**	**36.28%**	**45.46%**	**10.06%**	**52.56%**	**15.77%**

1.4 Analysis of the Past Due Subsidiary Ledger (SL) accounts of the Loans and receivables disclosed that the overdue accounts increased by P174.435 million or 54.18 per cent as at December 31, 2019 compared to December 31, 2018 SL balances. The increase was primarily due to the past due accounts under Finance receivables, Restructured loans, and Other loans and receivable accounts as shown below:

Past Due Accounts	2019	2018	Increase/(decrease)	
			Amount	Percentage
Lease Contract Receivables	P 61,810,511	P 88,008,577	P (26,198,066)	-29.77%
Other loans and receivables	103,113,817	67,605,345	35,508,472	52.52%
Finance receivables	221,530,393	121,608,356	99,922,037	82.17%
Factoring receivables	7	7	0	0.00%
Restructured loans	104,054,998	41,015,452	63,039,546	153.70%
Sales contract receivables	228,775	584,191	(355,416)	-60.84%
Accounts receivables	5,624,664	3,105,837	2,518,827	81.10%
Total	**P496,363,165**	**P321,927,765**	**P174,435,400**	**54.18%**

1.5 Per inquiry, the Remedial Management and Legal Enforcement Department (RMLED) regularly conducts monthly meetings to discuss the past due clients' status updates and actions to be taken to lower the past due level of the Company. The Past Due Report of the RMLED for CY 2019 and 2018 is summarized below:

Management Strategy/Disposition	2019		2018	
	No. of Accounts	Amount	No. of Accounts	Amount
For restructuring	7	P156,594,932	4	P 69,576,438
Under corporate rehabilitation	1	90,432,334	1	90,432,334
Under litigation	2	63,955,475	0	0
Under liquidation	1	27,548,738	1	27,908,738
Collection/payment catch - up	8	39,239,376	0	0
For collection case filing	1	12,787,364	1	77,521,821
For voluntary surrender	1	10,833,805	1	12,446,870
Collection case on-going	0	0	3	84,182,840
For account updating	0	0	1	18,734,494
Collection case - In favor of ULFC	0	0	1	18,400,000
Total	**21**	**P401,392,024**	**13**	**P399,203,535**

1.6 Despite the above strategies of management, there was no improvement in the credit quality and they were not able to bring down past due ratio to 12 percent in 2019. The accumulation of past due loans and receivables affected the available cash resources of the Company considering that the expected cash collection from these loans and receivables were not realized. Also, the non-collection of the loans and receivables resulted in the increase of accounts written off in CY 2019 by P46.031 million or 46.02 per cent as shown in the succeeding table.

Particulars	2019	2018	Increase/ (decrease)
Lease Contract Receivables	P 18,096,175	P 31,369,515	P(13,273,340)
Other loans and receivables	33,280,461	1,240,249	32,040,212
Finance receivables	94,672,816	55,900,365	38,772,451
Restructured loan receivables	0	11,508,488	(11,508,488)
Total	**P146,049,452**	**P100,018,617**	**P 46,030,835**

1.7 Although writing off of accounts will decrease the past due ratio of the Company, Management is still required to exhaust all efforts in the collection and consider it only as a last resort since write off will decrease the total assets.

1.8 **We recommended that Management strictly implement the strategies and action plans to intensify collection efforts in order to improve its credit quality.**

1.9 ULFC Management gave the assurance that the Company is exerting all efforts to improve its collection and implement account restructuring to bring down the past due ratio and write off accounts annually, if deemed necessary.

2. **Unserviceable properties with a total cost of P263,862, recognized under the Other Assets account, were not disposed contrary to Section 79 of Presidential Decree No. 1445 (PD 1445). Also, properties totaling P0.769 million were not accounted as at year-end.**

2.1 Section 79 of PD 1445 provides the following:

> *Destruction or sale of unserviceable property. When government property has become unserviceable for any cause, or is no longer needed, it shall, upon application of the officer accountable therefor, be inspected by the head of the agency or his duly authorized representative in the presence of the auditor concerned and, if found to be valueless or unsalable, it may be destroyed in their presence. If found to be valuable, it may be sold at public auction to the highest bidder under the supervision of the proper committee an award or similar body in the presence of the auditor concerned or other duly authorized representative of the Commission, after advertising by printed notice in the Official Gazette, or for not less than three consecutive days in any newspaper of general circulation, or where the value of the property does not warrant the expense of publication, by notices posted for a like period in at least three public places in the locality where the property is to be sold. In the event that the public auction fails, the property may be sold at a private sale at such price as may be fixed by the same committee or body concerned and approved by the Commission.*

2.2 Verification of accounts revealed that various properties and equipment totaling P1.063 million were considered as unserviceable, unaccounted and unclassified by Management as at December 31, 2019, detailed as follows:

Particulars	Cost	Accumulated Depreciation	Net Book Value
Unserviceable assets	P 263,862	P 263,845	P17
Unaccounted assets	769,362	769,360	2
Unclassified assets	29,868	29,853	15
Total	**P1,063,092**	**P1,063,058**	**P34**

2.3 These assets were reclassified from Property and equipment account to Other assets account at net book value of P34 pending the disposition of the unaccounted and unclassified properties and its subsequent disposal.

2.4 The unaccounted and unclassified assets were acquired in 2014 and 2007, respectively. As at reporting date, the status/condition and proper identification of these assets were not yet determined by the Management but these were fully depreciated and recognized in the books at nominal value of P1 per asset.

2.5 Management has not yet determined the disposal method to be undertaken and the timeline for the disposal of the unserviceable assets. Currently, the Company does not have written and approved policy regarding the disposal of unserviceable assets but they are following the Parent Bank's (UCPB) policies.

2.6 The unserviceable properties which were not yet disposed are exposed to elements that contribute to further deterioration and decline in value. Also, the accumulation of these items requires additional storage space. The non-disposal of properties which are already unserviceable or no longer needed is not in accordance with Section 79 of PD 1445.

2.7 **We recommended that ULFC:**

a. **Dispose the unserviceable assets then, de-recognize these from the books;**

b. **Establish accountability for the unaccounted assets and determine the proper classification of the unclassified assets; and**

c. **Establish policies and guidelines on the disposal of unserviceable assets and consider the inclusion of a specific timeline for regular disposal to prevent the accumulation of properties no longer needed.**

B. COMPLIANCE AUDIT

3. **The Company's Operations Manual on Loan Loss Estimation Methodology and Allowance for Credit Losses (ACL) is not aligned with BSP Circular No. 1011 Series of 2018.**

3.1 Sections 1 and 11 of Attachment 2 of BSP Circular No. 1011 on Guidelines on the Adoption of PFRS 9 – Impairment requires that:

> *Section 1 - Bangko Sentral supervised financial institutions (BSFIs) shall adopt the expected credit loss (ECL) model in measuring credit impairment, in accordance with the provisions of PFRS 9. In this respect, BSFIs shall recognize credit impairment/allowance for credit losses even before an objective evidence of impairment becomes apparent. BSFIs shall consider past events, current conditions, forecasts of future economic conditions in assessing impairment.*
>
> *X x x.*
>
> *b) Credit exposures shall be classified into three stages using the following time horizons in measuring ECL:*

Stage of credit impairment	*Characteristics*	*Time Horizon in Measuring ECL*
Stage 1	- *Credit exposures that are considered "performing" and with no significant increase in credit risk since initial recognition or with low credit risk*	*Twelve (12) months*
Stage 2	- *Credit exposures that are considered "under-performing" or not yet non-performing but with significant increase in credit risk since initial recognition*	*Lifetime*
Stage 3	- *Credit exposures with objective evidence of impairment, thus, considered as "non-performing"*	*Lifetime*

> *Xxxx.*
>
> *Section 11 – General and Specific Provisions for Loan Accounts*
>
> *a. BSFIs shall treat Stage 1 provisions for loan accounts as General Provision (GP), while Stages 2 and 3 provisions shall be treated as Specific Provisions (SP).*
>
> *X x x.*

3.2 The ULFC's Operations Manual provides the computation of impairment losses based on the approved ULFC Loan Loss Estimation Methodology and Allowance for Credit Losses (ACL).

3.3 Review of the existing and approved policy of the ULFC revealed that it is not updated and not aligned with the BSP Circular. We have noted the following deficiencies which are inconsistent with the guidelines set out in the BSP Circular:

a. The credit exposures were not classified into three stages using the time horizons in measuring ECL;

b. The ULFC policy includes Past Due or Restructured loans, and other credit accommodation in providing the minimum allowance for credit losses of one per cent;

c. Although both policies consider individual and collective assessment, the ULFC policy did not distinguish secured and unsecured loans and other exposures in its provisioning for Stage 2 and 3 accounts; and

d. The reserves factor per classification per ULFC Operations Manual for individually assessed loans and other credit accommodations provides five per cent (special mention); 25 per cent (substandard); 50 per cent (doubtful); 100 per cent (loss) without taking into consideration the circumstances provided in Attachment 3 of the Circular such as the loan security and other credit exposures, the number of days unpaid/with missed payment and other loan characteristics.

3.4 Management informed that in 2018, ULFC adopted and implemented the Parent Bank's (UCPB) ECL Methodology as approved by the ULFC's Board of Directors in August 2019 to comply with the PFRS requirements. Likewise, in 2019, the Company complied with PFRS 9 as represented by the Management and disclosed in Note 2.4(d) to the Financial Statements. It assessed its ECL on a forward-looking basis associated with its financial assets at amortized cost. The Company considers a broader range of information in assessing credit risk and expected credit losses, including past events, current conditions, reasonable and supportable forecasts that affect collectability of the future cash flows of the financial assets as disclosed in.

3.5 While ULFC is a subsidiary of UCPB, it is a separate entity with different operations and different types of loans and receivables which are subject to impairment, hence, need to have its own guidelines on the adoption of PFRS 9 aligned with the BSP Circular.

3.6 Moreover, Section 1.d of the BSP Circular – Guidelines on the adoption of PFRS 9 Financial Instruments requires that:

(1) Consistent with the duties and responsibilities of the board of directors provided under Subsection X143.1/4143Q.1 of the MORB/MORNBFI, the board of directors or any equivalent governing body in the case of branches of foreign banks, shall ensure that the BSFI appropriately and consistently adopts PFRS 9 as part of its reporting governance process. In this respect, the board shall assess the impact of PFRS 9 on business strategies and risk management systems and ensure

availability of sufficient resources, including capacity building initiatives in adopting the standard.

The board shall approve policies and guidelines relative to the adoption of PFRS 9, which shall cover responsibilities of the different units in the BSFI (e.g., Treasury, Risk Management, Financial Controllership) as well as the extent of participation or involvement of third parties in the adoption process. The board shall likewise ensure that adequate control measures are in place to ensure the integrity of reports.

(2) Management shall implement the policies set by the board related to the adoption of PFRS 9 and ensure that sound professional judgment is exercised in implementing the provisions of the standard. Management shall provide feedback to the board on the effectiveness of implementation of PFRS 9.

3.7 Considering the foregoing, the representation of the Company in the Notes to financial statements that it is compliant with PFRS 9 is inconsistent with the Operations Manual on Loan Loss Estimation Methodology and Allowance for Credit Losses which is not yet aligned with BSP Circular 1011. The BSP Circular requirement that the ULFC Board of Directors approve policies and guidelines on the adoption of PFRS 9 covering the responsibilities of the different units in the Company and ensure that adequate control measures are in place, is not complied with.

3.8 **We recommended that Management update the Company's Operations Manual on Loan Loss Estimation Methodology and Allowance for Credit Losses (ACL) to comply with PFRS 9 and BSP Circular No. 1011 Series of 2018.**

3.9 The Management committed to document and include their existing practice in the ULFC Manual of Policies and Guidelines not later than September 2020.

4. **The granting and liquidation of cash advances was not in accordance with the ULFC Administrative Manual of Operations and Policy Guidelines, resulting in the accumulation of unliquidated cash advances from 91 days to more than two years.**

4.1 The Items 4.3 and 4.7 Section 4 Chapter V of the ULFC Administrative Manual of Operations and Policy Guidelines on Availment and Liquidation of Cash Advance requires that:

4.3. If the requesting employee has unliquidated cash advance, the request shall not be processed. For this purpose, all requests shall have to be forwarded first to the Unit Head's Secretary who shall ensure that no cash advance is granted to employees with outstanding cash advances.
4.7. The Unit Head's Secretary shall ensure that cash advances are liquidated in full within 5 banking days after the completion of the purpose for which the advance was availed.

4.2 Item 4.3 of the ULFC policy is consistent with COA Circular No. 97-002 dated February 10, 1997, however, there are requirements and limitations in the COA Circular on the granting, utilization and liquidation of cash advances which are not incorporated in the existing policy of the Company.

4.3 As at December 31, 2019, the Advances to officers and employees of the ULFC amounted to P37,519. Aging of the outstanding advances revealed that P33,269 or 88.67 per cent were outstanding beyond 30 calendar days. The Schedule of Aging of Advances to Officers and employees is shown below:

Purpose	Date Grant	Balance	Less than 30 days	91 days to 1 year	Over 1 years	Over 2 years
Expenses during client visit - Media Archives	10/23/2017	P11,900				P11,900
Filing fees	10/26/2018	5,830			P5,830	
Processing of Business Permit	1/10/2019	4,000		P4,000		
Filing fees	3/12/2019	9,139		9,139		
Courier service fees for insurance letters	5/10/2019	2,400		2,400		
Gasoline consumption	12/18/2019	3,000	P3,000			
Courier service fees for insurance letters	12/27/2019	1,250	1,250			
Total		**P37,519**	**P4,250**	**P15,539**	**P5,830**	**P11,900**

4.4 Validation of accounts revealed that the liquidation of most cash advances were made within two to 65 days. Cash advances were not liquidated within the required five days after completion of the purpose for which the advance was availed.

4.5 Further verification of accounts revealed that ULFC has granted additional cash advances to three officers and employees with outstanding balance, inconsistent with the aforecited policy guidelines, as shown below:

Officer Name	Outstanding cash advance		Subsequent cash advances	
	Booking date	Amount	Booking date	Amount
Officer A	10/26/2018	P5,830	3/22/2019	P 8,700
			5/10/2019	4,000
Officer B	3/12/2019	9,139	7/22/2019	2,000
			8/13/2019	3,500
			8/30/2019	700
			9/19/2019	13,925
			11/25/2019	3,700
Officer C	5/10/2019	2,400	6/10/2019	2,300
			7/10/2019	2,100
			8/13/2019	2,100
			9/9/2019	2,500
			10/10/2019	2,200

4.6 The breakdown in the implementation of the existing policies and guidelines of the Company on the granting and liquidation of advances to officers and employees resulted in the accumulation of unliquidated cash advances as at December 31, 2019.

4.7 **We recommended that Management:**

a. **Require the immediate liquidation of the outstanding cash advances as at December 31, 2019;**

b. **Strictly implement the provisions of the in the existing ULFC Administrative Manual of Operations and Policy Guidelines in the granting, utilization and liquidation of cash advances; and**

c. **Consider updating the policy and guidelines for cash advances and align with COA Circular No. 97-002 dated February 10, 1997.**

4.8 The outstanding cash advances as at December 31, 2019 were all liquidated as at June 30, 2020. The Management committed to updated its policy and align the same in accordance with COA Circular No. 97 – 002 as recommended not later than August 2020.

4.9 Also, it will endeavor to strictly implement its policy on granting cash advances to employees with unliquidated balances, liquidation of cash advances after completion of the purpose and regular monitoring of the outstanding cash advances.

Compliance with Tax Laws

5. Information on taxes, duties and license fees paid or accrued during the taxable year 2019 were disclosed in Note 23, Supplementary Information Required by the Bureau of Internal Revenue to the Financial Statements. The taxes withheld from compensation, benefits and other sources amounting to P1.436 million were remitted to the Bureau of Internal Revenue in accordance with the deadlines on payment/remittance of taxes prescribed under the National Internal Revenue Code.

SSS, Philhealth and Pag-IBIG Premiums

6. In 2019, the Company complied with Republic Act (RA) No. 8282 on the collection and remittance of contributions to SSS as follows:

a. Mandatory monthly contribution of covered employees and employer in accordance with Section 18; and

b. Remittance of employees' and employer's contributions and employees' compensation premium within the due date pursuant to Section 19.

7. ULFC also complied with Section 18, Rule III, Title III, of the implementing Rules and Regulations of RA No. 7875, as amended, in the payment of national health insurance premium contributions to the PhilHealth. The Company also complied with Sections 2 and 3, Rule VII, of the Implementing Rules and Regulations of RA No. 9679 in the collection and remittance to the Pag-IBIG Fund.