BDO LEASING AND FINANCE, INC. AND SUBSIDIARY
(Formerly PCI Leasing and Finance, Inc. and Subsidiary)
(A Subsidiary of Banco de Oro Unibank, Inc.)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2008 AND 2007
(With Comparative Figures for 2006)
(Amounts in Philippine Pesos)

1. CORPORATE MATTERS

1.1 Incorporation and Operations

BDO Leasing and Finance, Inc. (BDO Leasing or the Parent Company) is a domestic corporation incorporated in 1981 and listed in the Philippine Stock Exchange, Inc. on January 6, 1997. The Parent Company operates as a leasing and financing entity which provides direct leases, sale and leaseback arrangements and real estate leases. Financing products include amortized commercial and consumer loans, installment paper purchases, receivables discounting and factoring.

The Parent Company is a subsidiary of Banco de Oro Unibank, Inc. (BDO Unibank or the "Ultimate Parent Company"), an expanded commercial bank incorporated and doing business in the Philippines.

BDO Rental, Inc. (BDO Rental), a wholly-owned subsidiary of BDO Leasing, is licensed by the Philippine Securities and Exchange Commission (SEC) to engage in renting and leasing of equipment. It started its commercial operations on June 30, 2005.

The Parent Company's principal office is located at BDO Leasing Centre, Corinthian Gardens, Ortigas Avenue, Quezon City. It has eight branches located in the cities of Cebu, Davao, Dagupan, San Pablo, Cagayan de Oro, Iloilo, Pampanga and Cavite. The registered address of BDO Unibank is located at Benguet Center, 12 ADB Avenue, Ortigas Center, Mandaluyong City.

1.2 Change in Corporate Name

On July 30, 2007, the Board of Directors approved the change in the Parent Company's corporate name from PCI Leasing and Finance, Inc. to BDO Leasing and Finance, Inc. This change was subsequently approved by the SEC on June 13, 2008.

1.3 Approval of Financial Statements

The accompanying financial statements of BDO Leasing and subsidiary (the "Group") and of the Parent Company were authorized for issue by the Board of Directors on April 1, 2009.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of Preparation of Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards (PFRS)

The financial statements of BDO Leasing and its subsidiary have been prepared in accordance with PFRSs. PFRSs are adopted by the Financial Reporting Standards Council (FRSC) from the pronouncements issued by the International Accounting Standards Board.

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, income and expense. These financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial assets. The measurement bases are more fully described in the accounting policies that follow.

(b) Functional and Presentation Currency

These financial statements are presented in Philippine pesos, the Group's functional currency, and all values represent absolute amounts except when otherwise indicated (see also Note 2.15).

2.2 Impact of New Amendments and Interpretations to Existing Standards

(a) Effective in 2008 that are Relevant to the Group

In 2008, the Group adopted for the first time the following new interpretation and amended standards which are mandatory in 2008.

Philippine Interpretation International Financial Reporting Interpretation Committee (IFRIC) 14	:	Philippine Accounting Standard (PAS) 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
PAS 39 and PFRS 7 (Amendments)	:	PAS 39, Financial Instruments: Recognition and Measurements and PFRS 7, Financial Instruments: Disclosures

Discussed below are the impact on the financial statements of this new accounting standards.

(i) Philippine Interpretation IFRIC 14, *PAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective from January 1, 2008). This Philippine Interpretation provides guidance on assessing the limit in PAS 19, *Employee Benefits*, on the amount of the surplus that can be recognized as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. The Group's adoption of this interpretation does not have any impact on the Group's financial statements, as it has a retirement benefit obligation and is not subject to any minimum funding requirements.

(ii) PAS 39 (Amendment), *Financial Instruments: Recognition and Measurement* and PFRS 7 (Amendment), *Financial Instruments: Disclosures* (effective from July 1, 2008). The amendments permit an entity to:

- Reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of fair value through profit or loss category in particular circumstances; and

- Transfer from the available for sale category to the loans and receivable category those financial assets that would have met the definition of loans and receivables, provided that the entity has the intention and the ability to hold those financial assets for the foreseeable future.

The amendments are applicable in a partially retrospective manner up to July 1, 2008 provided that the reclassification was made on or before November 15, 2008, the cut-off date set by the FRSC. After the cut-off date, all reclassifications will only take effect prospectively. As the Group did not exercise the option to reclassify its financial assets; hence, it determined that the adoption of these amendments has no impact on the 2008 financial statements.

The first time application of these interpretation and amendments has not resulted in any prior period adjustments of balance sheet, net income or cash flows line items.

(b) Effective in 2008 but not Relevant to the Group

The following interpretations to published standards are mandatory for accounting periods beginning on or after January 1, 2008 but are not relevant to the Group's operations:

Philippine Interpretation IFRIC 11	:	Group and Treasury Share Transactions
Philippine Interpretation IFRIC 12	:	Service Concession Arrangements

(c) Effective Subsequent to 2008

There are new and amended standards that are effective for periods subsequent to 2008. The following new standards, effective for annual periods beginning on or after January 1, 2009, are relevant to the Group which the Group will apply in accordance with their transitional provisions.

PAS 1 (Revised 2007)	:	Presentation of Financial Statements
PFRS 8	:	Operating Segments
Various Standards	:	2008 Annual Improvements to PFRS

Below is a discussion of the possible impact of these accounting standards.

(i) PAS 1 (Revised 2007), *Presentation of Financial Statements* (effective from January 1, 2009). The amendment requires an entity to present all items of income and expense recognized in the period in a single statement of comprehensive income or in two statements: a separate income statement and a statement of comprehensive income. The income statement shall disclose income and expense recognized in profit and loss in the same way as the current version of PAS 1. The statement of comprehensive income shall disclose profit or loss for the period, plus each component of income and expense recognized outside of profit and loss classified by nature (e.g., gains or losses on available-for-sale assets or translation differences related to foreign operations). Changes in equity arising from transactions with owners are excluded from the statement of comprehensive income (e.g., dividends and capital increase). An entity would also be required to include in its set of financial statements a statement showing its financial position (or balance sheet) at the beginning of the previous period when the entity retrospectively applies an accounting policy or makes a retrospective restatement. The Group will apply PAS 1 (Revised 2007) in its 2009 financial statements.

(ii) PFRS 8, *Operating Segments* (effective from January 1, 2009). PFRS 8 replaces PAS 13 and aligns segment reporting with requirements of the US standard SFAS 131, Disclosures about segments of an enterprise and related information. The new standard requires a management approach, under which segment information is presented on the same basis as that used for internal reporting purposes. The Group will apply PFRS 8 from January 1, 2009. The expected impact is still being assessed in detail by management, but it appears likely that the number of reportable segments, as well as the manner in which the segments are reported, will change in a manner that is consistent with the internal reporting provided to the chief operating decision-maker.

(iii) 2008 Annual Improvements to PFRS. The FRSC has adopted the Improvements to International Financial Reporting Standards 2008. These amendments become effective in the Philippines in annual periods beginning on or after January 1, 2009. The Group expects the amendments to the following standards to be relevant to the Company's accounting policies:

- PAS 19 (Amendment), *Employee Benefits.* The amendment includes the following:

  - Clarification that a curtailment is considered to have occurred to the extent that benefit promises are affected by future salary increases and a reduction in the present value of the defined benefit obligation results in negative past service cost.

  - Change in the definition of return of plan assets to require the deduction of plan administration costs in the calculation of plan assets return only to the extent that such costs have been excluded from measurement of the defined benefit obligation.

  - Distinction between short-term and long-term employee benefits will be based on whether benefits are due to be settled within or after 12 months of employee service being rendered.

  - Removal of the reference to recognition in relation to contingent liabilities in order to be consistent with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* which requires contingent liabilities to be disclosed and not recognized.

  The Group's management assessed that this amendment to PAS 19 will have no impact on its 2009 financial statements.

- PAS 40 (Amendment), *Investment Property.* PAS 40 is amended to include property under construction or development for future use as investment property in its definition of investment property. This results in such property being within the scope of PAS 40; previously, it was within the scope of PAS 16. Also, if an entity's policy is to measure investment property at fair value, but during construction or development of an investment property the entity is unable to reliably measure its fair value, then the entity would be permitted to measure the investment property at cost until construction or development is complete. At such time, the entity would be able to measure the investment property at fair value.

Minor amendments are made to several other standards; however, those amendments are not expected to have a material impact on the Group's financial statements.

2.3 Basis of Consolidation

The Parent Company obtains and exercises control through voting rights. The Group's financial statements comprise the accounts of the Parent Company and its subsidiary, after the elimination of material intercompany transactions. All intercompany balances and transactions with its subsidiary, including income, expenses and dividends, are eliminated in full.

The financial statements of the subsidiary are prepared for the same reporting period as the Parent Company, using consistent accounting principles.

A subsidiary is an entity over which the Group has the power to control the former's financial and operating policies. The Parent Company obtains and exercises control through voting rights. A subsidiary is consolidated from the date the Parent Company obtains control until such time that such control ceases.

An acquired subsidiary is subject to the application of the purchase method for acquisitions. This involves the revaluation at fair value of all identifiable assets and liabilities, including contingent liabilities of the subsidiary, at the acquisition date, regardless of whether or not they were recorded in the financial statements of the subsidiary prior to acquisition. On initial recognition, the assets and liabilities of the subsidiary are included in the Group balance sheets at their revalued amounts, which are also used as the bases for subsequent measurement in accordance with the Group accounting policies.

The results of subsidiary acquired or disposed of during the year, if any, are included in the Group income statements from the date of acquisition or up to the date of disposal, as appropriate.

2.4 Segment Reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

2.5 Financial Assets

Financial assets include cash and financial instruments. Financial assets, other than hedging instruments, are classified into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired. Except for financial assets at fair value through profit or loss, the designation of financial assets is re-evaluated at every reporting date at which date a choice of classification or accounting treatment is available, subject to compliance with specific provisions of applicable accounting standards.

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash.

Regular purchase and sales of financial assets are recognized on their trade date. All financial assets that are not classified as at fair value through profit or loss are initially recognized at fair value, plus transaction costs. Financial assets carried at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement.

The foregoing categories of financial instruments relevant to the Group are more fully described below.

(a) *Loans and Receivables*

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

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment losses. Any change in their value is recognized in profit or loss, except for changes in fair values of reclassified financial assets under PAS 39 and PFRS 7 (Amendments). Increases in estimates of future cash receipts from such financial assets shall be recognized as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amounts of the financial assets at the date of the change in estimate.

Impairment losses is the estimated amount of losses in the Group's loan portfolio, based on the evaluation of the estimated future cash flows discounted at the loan's original effective interest rate. Impairment loss is provided when there is objective evidence that the Group will not be able to collect all amounts due to it in accordance with the original terms of the receivables. Loans and receivables are written off against the allowance for impairment losses when management believes that the collectibility of the principal is unlikely.

The Group's loans and receivables are presented as Loans and Other Receivables in the balance sheets.

(b) *Available-for-sale Financial Assets*

This category includes non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets.

All financial assets within this category are subsequently measured at fair value, unless otherwise disclosed, with changes in value recognized in equity. Gains and losses arising from securities classified as available-for-sale are recognized in the income statement when these are sold or when the investment is impaired.

In case of impairment, any loss previously recognized in equity is transferred to the income statement. Losses recognized in the income statement on equity instruments are not reversed through the income statement. Losses recognized in prior period income statement resulting from the impairment of debt instruments are reversed through the income statement, when there is recovery in the amount of previously recognized impairment losses.

Available-for-sale Securities are presented as part of Other Assets in the balance sheets.

Impairment losses recognized on financial assets are included as part of Impairment and Credit Losses under Operating Costs and Expenses in the income statements (see Note 15).

For investments that are actively traded in organized financial markets, fair value is determined by reference to stock exchange-quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows (such as dividend income) of the underlying net asset base of the investment.

Non-compounding interest, dividend income and other cash flows resulting from holding financial assets are recognized in profit or loss when earned, regardless of how the related carrying amount of financial assets is measured.

Derecognition of financial assets occurs when the rights to receive cash flows from the financial instruments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

2.6 Property and Equipment

Property and equipment are carried at acquisition 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; expenditures for repairs and maintenance are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, their cost and related accumulated depreciation and amortization and any impairment losses are removed from the accounts and any resulting gain or loss is reflected in income for the period.

Except for certain equipment which are depreciated based on the rate of utilization, depreciation is computed on the straight-line method over the estimated useful lives of the depreciable assets as follows:

Transportation and other equipment	2-8 years
Furniture, fixtures, and others	3-5 years

Leasehold improvements are amortized over the terms of the leases or the estimated useful lives of the improvements, 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 2.17).

The residual values and estimated useful lives of property and equipment are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property and equipment 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 the income statement in the period the item is derecognized.

2.7 Investment Properties

Investment properties are stated at cost. The cost of an investment property comprises its purchase price and directly attributable cost incurred. This also includes properties acquired by the Parent Company from defaulting borrowers not held for sale in the next twelve months. For these assets, the cost is recognized initially at the fair market value. Investment properties except land are depreciated on a straight-line basis over a period of 10 years.

Subsequent to initial recognition, investment property is stated at cost less accumulated depreciation and any impairment in value.

The Group adopted the cost model in measuring its investment properties, hence, these are carried at cost less accumulated depreciation and any impairment in value. Depreciation and impairment loss are recognized in the same manner as in Property and Equipment.

Investment property is 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 an investment property is recognized in the income statement in the year of retirement or disposal.

2.8 Financial Liabilities

Financial liabilities of the Group include bills payable, accounts payable and other liabilities and lease deposits, which are measured at amortized cost using the effective interest method.

Financial liabilities are recognized when the Group becomes a party to the contractual agreements of the instrument. All interest related charges are included as part of Interest and Financing Charges under Operating Costs and Expenses in the income statements (see Note 15).

Bills payable are raised for support of long-term funding of operations. They are recognized at proceeds received, net of direct issue costs. 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 they are not settled in the period in which they arise.

Accounts payable and other liabilities are initially recognized at their fair value and subsequently measured at amortized cost less settlement payments.

Lease deposits are initially recognized at fair value. The excess of the principal amount of the deposits over its fair value is immediately recognized and is included as part of Fair Value Gains under Other Income in the income statements (see Note 14). Meanwhile, interest expense on the lease deposits is accrued using the effective interest method and is included as part of Interest and Financing Charges under Operating Costs and Expenses in the income statements (see Note 15).

Financial liabilities are derecognized from the balance sheet only when the obligations are extinguished either through discharge, cancellation or expiration.

2.9 Provisions

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and these 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 commitment that has resulted from past events, for example, legal disputes or onerous contracts.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the balance sheet date, including the risks and uncertainties associated with the present obligation.
Any reimbursement expected to be received in the course of settlement of the present obligation is recognized, if virtually certain as a separate asset, not exceeding the amount of the related provision.

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. In addition, long-term provisions are discounted to their present values, where time value of money is material.

Provisions are reviewed at each balance sheet date 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 financial statements.

Probable inflows of economic benefits that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the financial statements.

2.10 Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

2.11 Residual Value of Leased Assets

The residual value of leased assets, which approximates the amount of lease deposit paid by the lessee at the inception of the lease, is the estimated proceeds from the disposal of the leased asset at the end of the lease term. At the end of the lease term, the residual value receivable of the leased asset is generally applied against the lease deposit of the lessee.

2.12 Equity

Common stock is determined using the nominal value of shares that have been issued.

Additional paid-in capital includes any premiums received on the issuance of capital stock. Any transaction costs associated with the issuance of shares are deducted from additional paid-in capital.

Treasury shares are stated at the cost of re-acquiring such shares.

Fair value loss on available-for-sale securities pertains to cumulative mark-to-market valuation of available-for-sale securities.

Retained earnings include all current and prior period results as disclosed in the income statement.

2.13 Revenue and Expense Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria of income and expenses must also be met before revenue is recognized:

(a) *Interest income on finance lease receivables* – The interest income on finance lease 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 Group'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.

(b) *Interest* – Interest income and expenses are recognized in the income statement for all instruments measured at amortized cost using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

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

(c) *Rent* – Revenue is recognized in the income statement on a straight-line basis over the lease term, or on another systematic basis which is more representative of the time pattern in which the use or benefit derived from the leased asset is diminished.

(d) *Service fees* – Fees related to the administration and servicing a loan are recognized as revenue as the services are rendered.

Operating costs and expenses are recognized in the income statement upon utilization of the assets or services or at the date they are incurred.

2.14 Leases

The Group accounts for its leases as follows:

(a) *Group as Lessor*

Finance leases, where the Group transfers substantially all the risk and benefits incidental to ownership of the leased item to the lessee, are included in the balance sheets under Loans and Other Receivables account. A lease receivable is recognized at an amount equal to the net investment in the lease. The difference between the gross lease receivable and the net investment in the lease is recognized as unearned finance income.
All income resulting from the receivable is included as part of Interest and Discounts in the income statements. Leases where the Group does not transfer substantially all the risk and benefits of ownership of the assets are classified as operating leases.

Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the rental income. Contingent rents are recognized as revenue in the year in which they are earned.

(b) Group as Lessee

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

The Group 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.

2.15 Functional Currency and Foreign Currency Transactions

(a) Functional and Presentation Currency

Items included in the financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The financial statements are presented in Philippine peso, which is also the Group's functional and presentation currency.

(b) Transactions and Balances

The accounting records of the Group are maintained in Philippine pesos. Foreign currency transactions during the period are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

2.16 Impairment of Financial Assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about certain loss events, including, among others: significant financial difficulty of the issuer or debtor; a breach of contract, such as a default or delinquency in interest or principal payments; it is probable that the borrower will enter bankruptcy or other financial reorganization; the disappearance of an active market for that financial asset because of financial difficulties; or observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

(a) *Assets carried at amortized cost.* The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the Group includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and other receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. When practicable, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and historical loss experience for assets with credit risk characteristics similar to those in the group.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be consistent with changes in related observable data from period to period. The methodologies and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures including approval from the management and the Board of Directors has been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the impairment loss in the income statement.

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

(b) *Assets carried at fair value with changes charged to equity.* In the case of investments classified as available-for-sale financial assets, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the income statement.

(c) *Assets carried at cost.* The Group assesses at each balance sheet date whether there is objective evidence that any of the unquoted equity securities and derivative assets linked to and required to be settled in such unquoted equity instruments, which are carried at cost and for which objective evidence of impairment exist. The amount of impairment loss is the difference between the carrying amount of the equity security and the present value of the estimated future cash flows discounted at the current market rate of return of a similar asset. Impairment losses on assets carried at cost cannot be reversed.

2.17 Impairment of Non-financial Assets

The Group's property and equipment, investment properties and other assets are subject to impairment testing.

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, some assets are tested individually for impairment and some are tested at cash-generating unit level.

An impairment loss is recognized for the amount by which the asset or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation. Impairment loss is charged pro-rata to the other assets in the cash generating unit.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal of the impairment loss.

2.18 Employee Benefits

(a) Retirement Benefit Obligations

Pension benefits are provided to employees through a defined benefit plan. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of pension plan remains with the Group, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Group's defined benefit pension plan covers all regular full-time employees. The pension plan is tax-qualified, noncontributory and administered by a trustee.

The liability recognized in the balance sheet for defined benefit pension plans is the present value of the defined benefit obligation (DBO) at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The DBO is calculated annually by independent actuaries using the projected unit credit method. The present value of the DBO is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses are not recognized as an income or expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to profit or loss over the employees' expected average remaining working lives.

Actuarial gains and losses within the 10% corridor are disclosed separately. Past-service costs are recognized immediately in the income statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

A defined contribution plan is a pension plan under which the Group pays fixed contributions into an independent entity (such as the Social Security System). The Group has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognized if underpayment or prepayment has occurred and are included in current liabilities or current assets as they are normally of a short term nature.

(b) Termination Benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either: (a) terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or (b) providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

(c) Compensated Absences

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the balance sheet date. They are included in Accounts Payable and Other Liabilities account at the undiscounted amount that the Group expects to pay as a result of the unused entitlement.

2.19 Income Taxes

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 balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the period. All changes to current tax assets or liabilities are recognized as a component of tax expense in the income statement.

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

Under the balance sheet 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 deferred tax asset can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date 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.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in the income statement. Only changes in deferred tax assets or liabilities that relate to a change in value of resources or liabilities that is charged directly to equity are charged or credited directly to equity.

2.20 Earnings Per Share (EPS)

Basic earnings per common share is determined by dividing net income by the weighted average number of common shares subscribed and issued during the year, after retroactive adjustment for any stock dividend declared in the current period. The Group does not have dilutive common shares.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

3.1 Critical Management Judgments in Applying Accounting Policies

In the process of applying the Group'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) Operating and Finance Leases

The Parent Company has determined that it has transferred all the significant risks and rewards of ownership of the properties which are leased out on finance lease arrangements. Interest earned on finance lease arrangements amounted to P455.6 million, P432.5 million and P367.9 million in 2008, 2007 and 2006, respectively (see Note 6).

BDO Rental's operations involve operating leases. BDO Rental has determined that it retains all the significant risks and rewards of ownership over the properties which are leased out on operating lease arrangements. BDO Rental's rent income on operating lease arrangements amounted to P256.4 million, P58.4 million and P58.8 million in 2008, 2007 and 2006, respectively (see Note 17).

The Group has entered in various lease arrangements as a lessee. Critical judgment was exercised by management to distinguish each lease arrangement as either an operating or finance lease by looking at the transfer or retention of significant risks and rewards of ownership of the properties covered by the agreements.

Rental expense charged to operations included as part of Occupancy and Equipment-Related Expenses under Operating Costs and Expenses in the income statements amounted to P13.6 million in 2008, P13.5 million in 2007 and P12.9 million in 2006 in the Group and Parent Company financial statements (see Note 15).

(b) *Distinction Between Investment Properties and Owner-managed Properties*

The Group determines whether a property qualifies as investment property. In making its judgment, the Group 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.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use in the production and supply of goods and services or for administrative purposes. If these portion can be sold separately (or leased out separately under finance lease), the Group accounts for the portions separately. If the portion cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Group considers each property separately in making its judgment.

(c) *Provisions and Contingencies*

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition and disclosure of provision and disclosure of contingencies are discussed in Note 2.9 and relevant disclosures are presented in Note 23.

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 balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

(a) Useful Lives of Property and Equipment

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

Property and equipment, net of accumulated depreciation and amortization, amounted to P1.649 billion and P0.3 billion as of December 31, 2008 and 2007, respectively, in the Group financial statements and P15.2 million and P8.2 million as of December 31, 2008 and 2007, respectively, in the Parent Company financial statements (see Note 7).

There is no change in estimated useful lives of property and equipment during the year.

(b) Allowance for Impairment of Loans and Other Receivables

Allowance is made for specific and groups of accounts, where objective evidence of impairment exists. The Group evaluates these accounts based on available facts and circumstances, including, but not limited to, the length of the Group's relationship with the customers, the customers' current credit status based on third party credit reports and known market forces, average age of accounts, collection experience and historical loss experience.

Impairment losses on loans and other receivables amounted to about P75.0 million in 2008, P157.3 million in 2007 and P16.0 million in 2006 in the Group and Parent Company financial statements (see Note 6).

(c) Realizable Amount of Deferred Tax Assets

The Group reviews its deferred tax assets at each balance sheet date 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.

Deferred tax assets recognized gross of deferred tax liabilities, amounted to P62.4 million and P102.7 million as of December 31, 2008 and 2007, respectively, in the Group financial statements and P57.8 million and P97.9 million as of December 31, 2008 and 2007, respectively, in the Parent Company financial statements (see Note 21).