[BSP CIRCULAR NO. 494, September 20, 2005]

GUIDELINES ON THE ADOPTION OF PHILIPPINE FINANCIAL REPORTING STANDARDS AND PHILIPPINE ACCOUNTING STANDARDS

The Monetary Board in its Resolution Nos. 1110 and 1194 dated 18 August 2005 and 8 September 2005, respectively, approved the following guidelines in adopting the provisions of the Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS) effective the annual financial reporting period beginning 1 January 2005, both for purposes of prudential reporting and audited financial statements.

SECTION 1. Statement of Policy - It is the policy of the Bangko Sentral ng Pilipinas to promote fairness, transparency and accuracy in financial reporting. It is in this light that the BSP aims to adopt all Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS) issued by the Accounting Standards Council (ASC) to the greatest extent possible.

SECTION 2. Accounting Treatment for Prudential Reporting - For prudential reporting, financial institutions shall adopt in all respect the PFRS and PAS except as follows:

a. In preparing consolidated financial statements, only investments in financial allied subsidiaries except insurance subsidiaries shall be consolidated on a line-by-line basis; while insurance and non-financial allied subsidiaries shall be accounted for using the equity method. Financial/non-financial allied/non-allied associates shall be accounted for using the equity method in accordance with the provisions of PAS 28 "Investments in Associates". For purposes of preparing separate financial statements, financial/non-financial allied/non-allied subsidiaries/associates, including insurance subsidiaries/associates, shall also be accounted for using the equity method; and

b. Financial institutions shall be required to meet the BSP recommended valuation reserves.

Nonwithstanding these exceptions, the audited annual financial statements required to be submitted to the BSP in accordance with the provisions of Subsection X164.1 of the Manual of Regulations for Banks (MORB) and Section 4172Q of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFI) shall in all respect be PFRS/PAS compliant: Provided, That financial institutions shall submit to the BSP adjusting entries reconciling the balances in the financial statements for prudential reporting with that in the audited annual financial statements.

SECTION 3. Accounting Treatment of Specific Items - The following rules and regulations shall govern the accounting treatment of specific items for purposes of prudential reporting and audited financial statements.

a. *Derivatives* - Derivatives shall be accounted in accordance with the provisions of PAS 39 "Financial Instruments: Recognition and Measurement" which states that derivatives shall be reported on balance sheet with any gain or loss from fair value changes reported in profit or loss. Derivatives and non-derivatives financial assets and liabilities qualifying for hedge accounting shall likewise conform with the guidelines of PAS 39.

Accordingly, Appendix 27 of the MORB and Appendix Q-17 of the MORNBFI on the accounting guidelines for derivatives are hereby superseded.

b. *Bank/Other Financial Institution Premises, Furniture, Fixture and Equipment* - Bank/Other financial institution premises, furniture, fixture and equipment shall be accounted for using the cost model under PAS 16 "Property, Plant and Equipment."

Outstanding appraisal increment as of the effectivity of this Circular arising from mergers and consolidation shall be deemed part of the cost of the assets. However, appraisal increment booked in accordance with Subsection X606.1 of the MORB and Subsection 4651Q.1 of the MORNBFI shall be reversed.

Accordingly, Subsection X606.1 of the MORB and Subsection 4651Q.1 of the MORNBFI, which allow the booking of appreciation or increase in the book value of bank/NBQB premises and other fixed assets in cases where the market value of the property has greatly increased since the original purchase subject, among others, to the prior notification to the appropriate supervision and examination departments of the BSP are hereby deleted.

c. *Real and Other Properties Acquired (ROPA)*

1. Real and other properties acquired (ROPA) in settlement of loans through foreclosure or dation in payment shall be booked initially at the carrying amount of the loan (i.e., outstanding loan balance adjusted for any unamortized premium or discount less allowance for probable losses computed based on PAS 39 provisioning requirements) plus booked accrued interest less allowance for probable losses plus transaction costs incurred upon acquisition (such as non-refundable capital gains tax and documentary stamp tax paid in connection with the foreclosure/purchase of the acquired real estate property): *Provided*, That where the booked amount of ROPA exceeds the appraised value of the acquired property, an allowance for probable losses equivalent to the excess of the amount booked over the appraised value shall be set up: *Provided, further*, That if the carrying amount of ROPA exceeds P5 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP.

2. The carrying amount of ROPA shall be allocated to land, building, other non-financial assets and financial assets (e.g., receivables from third party or equity interest in an entity) based on their fair values, which allocated carrying amounts shall become their initial costs.

3. Subsequently, ROPA shall be accounted for as follows:

   a. Land and buildings shall be accounted for using the cost model under PAS 40 "Investment Property";

b. Other non-financial assets shall be accounted for using the cost model under PAS 16 "Property Plant and Equipment";

c. Buildings and other non-financial assets shall be depreciated over a period not exceeding ten years and three years, respectively.

d. Land, buildings and other non-financial assets shall be subject to the impairment provisions of PAS 36 "Impairment";

e. Financial assets shall be initially booked and classified according to intention (i.e, HFT, DFVPL, AFS, HTM, INMES, Unquoted Debt Securities Classified as Loans or Loans and Receivable) and accounted for in accordance with the provisions of PAS 39;

f. ROPAs that comply with the provisions of PFRS 5 "Non-Current Assets Held for Sale" shall be reclassified and accounted for as such.

4. Claims arising from deficiency judgments rendered in connection with the foreclosure of mortgaged properties shall be lodged under the real account "Deficiency Judgment Receivable"; while probable claims against the borrower arising from the foreclosure of mortgaged properties shall be lodged under the contingent account "Deficiency Claims Receivable".

5. *Appraisal of Properties*. Before foreclosing or acquiring any property in settlement of loans, it must be properly appraised to determine its true economic value. If the amount of ROPA to be booked exceeds P5 million, the appraisal must be conducted by an independent appraiser acceptable to the BSP. An in-house appraisal of all ROPAs shall be made at least every other year. Provided, that immediate re-appraisal shall be conducted on ROPAs which materially decline in value.

6. *Non-Cash Payment for Interest* - Financial institutions that accept non-cash payments for interest on their borrowers' loans shall book the acquired assets as ROPA. The amount to be booked as ROPA shall be booked accrued interest less allowance for probable losses: *Provided*, That where the booked amount of ROPA exceeds the appraised value of the acquired property, an allowance for probable losses equivalent to the excess of the amount booked over the appraised value shall be set up: *Provided, further*, That if the carrying amount of ROPA exceeds P5 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP. The carrying amount of ROPA shall be allocated in accordance with Item (c)2 and shall be subsequently accounted for in accordance with Item (c)3 of this Section.

7. *Sales Contract Receivable (SCR)* shall be recorded based on the present value of the installments receivables discounted at the inputed rate of interest. Discount shall be accreted over the life of the SCR by crediting interest income using the effective interest method. Any difference between the present value of the SCR and the derecognized assets shall be recognized in profit or loss at the date of sale in accordance with the provisions of PAS 18 "Revenue" *Provided, furthermore*, That SCR shall be subject to impairment provision of PAS 39.

Accordingly, Section X 611 and Subsections X 611.1, X611.2 and X611.3 of the MORB and Section 4109Q and Subsections 4109Q.1, 4109Q.2, and 4109Q.3 of the MORNBFI on the accounting treatment of ROPA are hereby superseded.

8. Transitional Provisions. The provisions of Section 3(c) shall be applied to real and other properties acquired on 1 January 2005 and thereafter. *Provided*: That (a) Section 3(c)3(e) of this Circular shall be immediately adopted for all outstanding financial assets acquired before 1 January 2005; and (b) Section 3(c)7 of this Circular shall be immediately adopted for all outstanding Sales Contract Receivables entered into before 1 January 2005. *Provided, further*, That all land, buildings and other non-financial assets acquired before 1 January 2005 shall continue to be provided with valuation reserves in accordance with the schedule in Appendix 18 of the MORB and Appendix Q-10 of the MORNBFI.

d. *Goodwill*. Goodwill shall be accounted for in accordance with the provisions of PFRS 3 "Business Combination", and shall be subject to impairment provisions of PAS 36 "Impairment". In this regard, financial institutions with outstanding goodwill arising from mergers and consolidation approved by the Monetary Board shall apply PFRS 3 prospectively. Therefore the financial institution shall:

1. beginning the annual period beginning on 1 January 2005 shall discontinue amortizing such goodwill;

2. at the beginning of the annual period beginning on 1 January 2005, eliminate the carrying amount of the related accumulated amortization with a corresponding decrease in goodwill; and

3. from the beginning of the first annual period beginning on 1 January 2005 test the goodwill for impairment in accordance with PAS 36.

Accordingly Subsection X112.e of the MORB and Appendix 4112Q.e of the MORNBFI are hereby deleted.

e. *Foreign Exchange Transactions* - Foreign exchange transactions shall be accounted for in accordance with the provisions of PAS 21 "Effects of Changes in Foreign Exchange Rates." In this regard, revaluation of foreign currency monetary items shall be done at least monthly, using the Philippine Dealing System (PDS) Peso/US Dollar closing rate and the New York US Dollar/Third currencies closing rates. Foreign borrowings booked under bills payable, the foreign exchange risk of which is shouldered by the

National Government and past due accounts shall be revalued in accordance with the provisions of PAS 21.

f. *Redeemable Preferred Shares* - Redeemable preferred shares and preferred shares of similar nature shall be accounted for as a liability or equity instrument in accordance with the provisions of PAS 32 "Financial Instruments: Disclosure and Presentation." For this purpose, mandatorily redeemable preferred shares and preferred shares of similar nature accounted for as a financial liability shall be booked as a debt instrument in the books of both the issuer and the investor.

g. *Interest Accrual on Past Due Loans* - Interest income on past due loans arising from discount amortization (and not from the contractual interest of the accounts) shall be accrued as provided in PAS 39.