Philippine National Bank

2004 Annual Report

Financial Statements

Statement of Management's Responsibility for Financial Statements

The management of Philippine National Bank and its Subsidiaries (the Group) and of Philippine National Bank (Parent Company) is responsible for all information and representations contained in the consolidated and parent company statements of condition as of December 31, 2004 and 2003 and the related statements of income, changes in capital funds and cash flows for the years ended December 31, 2004, 2003 and 2002. These financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the Group's and Parent Company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the aforementioned financial statements before such statements are approved and submitted to the stockholders of the company.

SyCip, Gorres, Velayo and Co., the independent auditors appointed by the stockholders, has examined the financial statements of the company in accordance with generally accepted auditing standards in the Philippines and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to the Board of Directors and stockholders.

FRANCISCO A. DIZON
Chairman of the Board

OMAR BYRON T. MIER
Acting President

CARMEN G. HUANG
Executive Vice President & Chief Financial Officer

SUBSCRIBED AND SWORN to before me this 14th day of April 2005 affiants exhibiting to me their Community Tax Certificates, as follows:

Names	CTC No.	Date of Issue	Place of Issue
Francisco A. Dizon	14675290	January 24, 2005	Makati City
Omar Byron T. Mier	15754322	January 13,2005	Quezon City
Carmen G. Huang	14680481	January 26, 2005	Makati City

Atty. RUTH PAMELA E. TANGHAL-MANUBAG
Notary Public
Until 31, December 2005
Roll No. 46369
PTR NO. 0048795/1-11-05/Pasay City
IBP No. 628578/12-17-04/PPLM

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Report of Independent Auditors

SGV & Co

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SEC Accreditation No. 0012-F

The Stockholders and the Board of Directors
Philippine National Bank
PNB Financial Center
President Diosdado Macapagal Boulevard
Pasay City

We have audited the accompanying statements of condition of Philippine National Bank and Subsidiaries (the Group) and of Philippine National Bank (the Parent Company) as of December 31, 2004 and 2003, and the related statements of income, changes in capital funds and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Group's and of the Parent Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 5 and 6 to the financial statements, to take advantage of incentives under Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002*, and at the same time improve its chances of recovering from its receivable from National Steel Corporation (NSC), the Parent Company together with the NSC Liquidator, other secured creditors and shareholders of NSC sold the NSC assets to the SPV Companies. In consideration for its share in the NSC assets sold amounting to ₱5.3 billion, the Parent Company received cash and zero-interest coupon notes totalling ₱4.2 billion resulting in a loss of ₱1.1 billion representing the allowance for probable losses specifically provided for the NSC receivable but released to cover other probable losses of the Parent Company. In addition, no provision was made for the difference between the net carrying value of the zero-interest coupon notes, Tranches A and B totalling ₱3.8 billion as of December 31, 2004 (net of additional cash payment of ₱140.3 million and allowance for probable losses of ₱259.8 million), received from the SPV companies and the present value of such notes amounting to ₱1.9 billion discounted at 13.24% per annum for 5 years and 8 years, respectively. The loss from such sale of ₱1.1 billion and the difference between the net carrying value of the zero-interest coupon notes and its present value of ₱1.9 billion were deferred over a ten-year period in accordance with regulatory accounting principles prescribed by the Bangko Sentral ng Pilipinas for banks and other financial institutions availing of the provisions of RA No. 9182. Had such losses been charged against current operations, as required by generally accepted accounting principles, investment securities, deferred charges and capital funds as of December 31, 2004 would have decreased by ₱1.9 billion, ₱1.1 billion and ₱3.0 billion, respectively, and net income in 2004 would have been decreased by ₱3.0 billion.

In our opinion, except for the effects on the 2004 financial statements of the matters discussed in the third paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Group and of the Parent Company as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the Philippines.

SyCip Gorres Velayo & Co

Amelia B. Cabal
Partner
CPA Certificate No. 15534
SEC Accreditation No. 0068-A
Tax Identification No. 105-342-543
PTR No. 1195833, January 3, 2005, Makati City

April 8, 2005

SGV & Co is a member practice of Ernst & Young Global

Statements of Condition

(In Thousand Pesos)

	Group		Parent Company	
	December 31			
	2004	2003 (As Restated - Note 3)	2004	2003 (As Restated - Note 3)
RESOURCES				
Cash and Other Cash Items (Note 12)	**₱3,342,672**	₱3,257,207	**₱3,342,466**	₱3,205,026
Due from Bangko Sentral ng Pilipinas (Note 12)	**3,765,737**	1,115,502	**3,765,737**	1,115,502
Due from Other Banks	**7,051,470**	5,807,556	**6,092,449**	5,142,524
Interbank Loans Receivable (Note 27)	**18,921,030**	13,785,136	**18,882,242**	13,742,241
Securities Held Under Agreements to Resell	**4,000,000**	5,400,000	**4,000,000**	5,400,000
Trading Account Securities, at fair market value (Note 4)	**754,703**	1,002,455	**712,229**	965,899
Investment Securities - net (Notes 2, 5, 12, and 21)	**63,033,848**	47,326,768	**60,930,559**	44,998,375
Receivables from Customers - net (Notes 2, 6 and 23)	**56,151,608**	60,040,313	**54,002,036**	58,205,304
Bank Premises, Furniture and Equipment, at cost - net (Note 7)	**726,764**	678,833	**633,584**	607,687
Bank Premises, at appraised value - net (Notes 2, 7 and 16)	**14,680,353**	14,869,381	**14,669,857**	14,812,915
Investments in Subsidiaries and Associates - net (Notes 8 and 16)	**782,704**	739,611	**7,059,371**	6,737,815
Real and Other Properties Owned or Acquired - net (Notes 2 and 9)	**24,827,015**	24,882,574	**24,826,439**	24,881,999
Other Resources - net (Note 10)	**18,403,652**	18,246,056	**17,684,027**	18,042,548
	₱216,441,556	₱197,151,392	**₱216,600,996**	₱197,857,835

LIABILITIES AND CAPITAL FUNDS				
Liabilities				
Deposit Liabilities (Note 12)				
Demand	**₱14,476,485**	₱13,122,823	**₱14,433,937**	₱13,223,617
Savings	**120,041,480**	106,610,304	**119,997,438**	106,571,865
Time	**26,491,088**	26,182,061	**28,548,468**	28,495,616
	161,009,053	145,915,188	**162,979,843**	148,291,098
Bills and Acceptances Payable (Notes 2 and 13)	**13,534,658**	12,549,928	**12,895,473**	11,930,114
Due to Bangko Sentral ng Pilipinas (Note 15)	**103,326**	178,064	**103,326**	178,064
Margin Deposits and Cash Letters of Credit (Note 15)	**137,991**	202,189	**137,991**	202,189
Manager's Checks and Demand Drafts Outstanding (Note 15)	**477,893**	632,591	**477,893**	632,591
Accrued Taxes, Interest and Other Expenses (Note 15)	**6,043,362**	8,374,387	**5,980,389**	8,262,278
Subordinated Debt (Note 14)	**3,000,000**	–	**3,000,000**	–
Other Liabilities (Note 15)	**9,778,682**	7,084,858	**8,669,490**	6,147,314
	194,084,965	174,937,205	**194,244,405**	175,643,648
Capital Funds (Notes 2, 3, 5, 7, 8, 16, 21 and 25)				
Preferred stock	**7,807,018**	7,807,018	**7,807,018**	7,807,018
Common stock	**15,122,819**	15,122,819	**15,122,819**	15,122,819
Capital paid in excess of par value	**545,745**	545,745	**545,745**	545,745
Surplus reserves	**481,694**	445,146	**481,694**	445,146
Deficit	**(3,242,226)**	(3,558,857)	**(3,242,226)**	(3,558,857)
Revaluation increment on land and buildings	**1,288,272**	1,291,648	**1,288,272**	1,291,648
Accumulated translation adjustment	**496,817**	433,702	**496,817**	433,702
Net unrealized gain (loss) on available-for-sale securities	**(143,548)**	126,966	**(143,548)**	126,966
	22,356,591	22,214,187	**22,356,591**	22,214,187
	₱216,441,556	₱197,151,392	**₱216,600,996**	₱197,857,835

See accompanying Notes to Financial Statements.

Statements of Income

(In Thousand Pesos, Except Earnings (Loss) Per Share Amounts)

	Group			Parent Company		
	Years Ended December 31					
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
INTEREST INCOME ON						
Receivables from customers (Notes 6 and 23)	**₱4,753,299**	₱3,947,200	₱3,897,283	**₱4,552,212**	₱3,791,603	₱3,802,884
Trading and investment securities (Note 5)	**4,015,209**	3,066,489	2,640,229	**3,900,620**	2,926,658	2,516,652
Deposits with banks and others (Note 10)	**468,401**	586,406	632,327	**387,745**	511,127	486,308
	9,236,909	7,600,095	7,169,839	**8,840,577**	7,229,388	6,805,844
INTEREST EXPENSE ON						
Deposit liabilities (Note 12)	**4,845,233**	4,790,052	5,241,723	**4,863,293**	4,789,687	5,246,743
Bills payable and other borrowings (Notes 13 and 14)	**1,156,612**	924,690	1,057,216	**1,125,620**	905,501	1,050,193
	6,001,845	5,714,742	6,298,939	**5,988,913**	5,695,188	6,296,936
NET INTEREST INCOME	**3,235,064**	1,885,353	870,900	**2,851,664**	1,534,200	508,908
PROVISION FOR PROBABLE LOSSES (Note 11)	**840,913**	447,426	2,171,225	**808,973**	416,543	2,127,243
NET INTEREST INCOME (EXPENSE) AFTER PROVISION FOR PROBABLE LOSSES	**2,394,151**	1,437,927	(1,300,325)	**2,042,691**	1,117,657	(1,618,335)
OTHER INCOME						
Service charges, fees and commissions	**2,995,724**	2,678,976	2,229,010	**2,134,003**	1,929,442	1,608,094
Foreign exchange gains - net	**1,346,674**	1,401,864	1,252,567	**845,131**	874,650	814,913
Trading and investment securities gains - net	**417,898**	338,691	268,735	**412,336**	316,336	253,597
Equity in net earnings (losses) of subsidiaries and associates (Note 8)	**30,219**	59,754	52,043	**331,586**	(74,774)	340,205
Miscellaneous (Notes 20 and 23)	**1,487,566**	2,159,481	1,832,349	**1,346,752**	1,937,947	1,622,181
	6,278,081	6,638,766	5,634,704	**5,069,808**	4,983,601	4,638,990
OTHER EXPENSES						
Compensation and fringe benefits (Note 17)	**3,364,303**	3,697,292	3,140,690	**2,732,760**	2,679,700	2,553,341
Occupancy and equipment-related costs (Note 18)	**759,212**	745,322	663,224	**625,031**	613,987	614,114
Depreciation and amortization (Note 7)	**469,089**	457,339	514,967	**428,429**	436,794	469,612
Taxes and licenses (Note 19)	**868,843**	272,859	755,538	**841,498**	262,485	747,138
Miscellaneous (Notes 7 and 20)	**2,239,464**	2,263,165	2,450,991	**1,652,809**	1,626,386	1,948,477
	7,700,911	7,435,977	7,525,410	**6,280,527**	5,619,352	6,332,682
INCOME (LOSS) BEFORE INCOME TAX	**971,321**	640,716	(3,191,031)	**831,972**	481,906	(3,312,027)
PROVISION FOR INCOME TAX (Notes 19 and 22)	**618,142**	588,516	531,859	**478,793**	429,706	410,863
NET INCOME (LOSS) (Notes 22 and 25)	**₱353,179**	₱52,200	(₱3,722,890)	**₱353,179**	₱52,200	(₱3,722,890)
Earnings (Loss) Per Share (Note 25)						
Basic	**₱0.62**	₱0.09	(₱8.72)	**₱0.62**	₱0.09	(₱8.72)
Diluted	**0.62**	0.09	(8.72)	**0.62**	0.09	(8.72)

See accompanying Notes to Financial Statements.

Statements of Changes in Capital Funds

(In Thousand Pesos)

	Years Ended December 31		
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
CAPITAL STOCK (Notes 2 and 16)			
Balance at beginning of year	**₱22,929,837**	₱22,929,837	₱22,684,228
Reduction in par value during the year (applied against deficit)	**–**	–	(7,561,409)
Balance after quasi-reorganization	**22,929,837**	22,929,837	15,122,819
Issuance of stocks during the year	**–**	–	7,807,018
Balance at end of year	**22,929,837**	22,929,837	22,929,837
CAPITAL PAID IN EXCESS OF PAR VALUE (Note 16)			
Balance at beginning of year	**545,745**	545,745	235,000
Transfer from accumulated translation adjustment (Notes 2, 8 and 16)	**–**	–	310,745
Balance at end of year	**545,745**	545,745	545,745
SURPLUS RESERVES			
Balance at beginning of year	**445,146**	416,599	390,973
Transfer from deficit (Note 21)	**36,548**	28,547	25,626
Balance at end of year	**481,694**	445,146	416,599
DEFICIT			
Balance at beginning of year, as previously reported (Note 16)	**(1,834,191)**	(1,974,222)	(8,877,094)
Effects of change in accounting for :			
Leases (Note 3)	**(47,044)**	(67,127)	(75,376)
Deferred taxes (Note 3)	**(1,677,622)**	(1,541,161)	241,382
Balance at beginning of year, as restated	**(3,558,857)**	(3,582,510)	(8,711,088)
Net income (loss) for the year (Note 25)	**353,179**	52,200	(3,722,890)
Transfer to surplus reserves (Note 16)	**(36,548)**	(28,547)	(25,626)
Deficit closed on quasi-reorganization (Notes 2 and 16)	**–**	–	8,877,094
Balance at end of year	**(3,242,226)**	(3,558,857)	(3,582,510)
REVALUATION INCREMENT ON LAND AND BUILDINGS			
Balance at beginning of year, as previously reported	**1,899,483**	1,537,760	1,031,424
Effect of change in accounting for deferred taxes (Note 3)	**(607,835)**	(492,084)	(330,056)
Balance at beginning of year, as restated	**1,291,648**	1,045,676	701,368
Net additional (deduction of) appraisal increment during the year (Note 7)	**(4,965)**	361,723	506,336
Reversal of (additional) deferred tax liability on appraisal increment (Note 3)	**1,589**	(115,751)	(162,028)
Balance at end of year	**1,288,272**	1,291,648	1,045,676
ACCUMULATED TRANSLATION ADJUSTMENT			
Balance at beginning of year	**433,702**	190,053	1,684,159
Additional translation adjustment during the year	**63,115**	243,649	132,324
Application against deficit on quasi-reorganization (Notes 2, 8 and 16)	–	–	(1,626,430)
Balance at end of year	**496,817**	433,702	190,053
NET UNREALIZED GAIN (LOSS) ON AVAILABLE-FOR-SALE SECURITIES (Notes 5 and 8)			
Balance at beginning of year, as previously reported	**186,714**	232,529	273,530
Effect of change in accounting for deferred taxes (Note 3)	**(59,748)**	(74,409)	(87,529)
Balance at beginning of year, as restated	**126,966**	158,120	186,001
Additional net unrealized loss during the year	**(330,262)**	(45,815)	(41,001)
Reversal of deferred tax liability on unrealized gain (Note 3)	**59,748**	14,661	13,120
Balance at end of year	**(143,548)**	126,966	158,120
	₱22,356,591	₱22,214,187	₱21,703,520

See accompanying Notes to Financial Statements.

Statements of Cash Flows

(In Thousand Pesos)

	Group			Parent Company		
	Years Ended December 31					
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
CASH FLOWS FROM OPERATING ACTIVITIES						
Income (loss) before income tax	**₱971,321**	₱640,716	(₱3,191,031)	**₱831,972**	₱481,906	(₱3,312,027)
Adjustments for:						
Provision for probable losses (Note 11)	**840,913**	447,426	2,171,225	**808,973**	416,543	2,127,243
Depreciation and amortization	**469,089**	457,339	514,967	**428,429**	436,794	469,612
Gain on sale of ROPOA	**(249,551)**	(261,469)	(408,817)	**(249,551)**	(261,469)	(408,817)
Equity in net losses (earnings) of investees (Note 8)	**(30,219)**	(59,754)	(52,043)	**(331,586)**	74,774	(340,205)
Dividends received (Note 8)	**7,210**	9,612	8,278	**25,627**	709,373	327,720
Impairment loss on bank premises (Note 7)	**–**	97,987	–	**–**	97,987	–
Changes in operating resources and liabilities:						
Decrease (increase) in amounts of:						
Trading account securities (Note 4)	**247,752**	1,703,242	(1,866,455)	**253,670**	488,267	(688,126)
Receivables from customers	**(1,172,583)**	3,804,710	(1,583,059)	**(826,079)**	4,219,111	(1,486,872)
Other resources	**2,017,793**	(4,087,714)	1,891,515	**2,466,411**	(4,994,873)	1,654,324
Increase (decrease) in amounts of:						
Deposit liabilities (Note 12)	**15,093,865**	11,336,410	12,382,448	**14,688,745**	11,171,835	13,110,729
Due to Bangko Sentral ng Pilipinas (Note 15)	**(74,738)**	(12,940)	25,438	**(74,738)**	(12,940)	25,438
Margin deposits and cash letters of credit (Note 15)	**(64,198)**	135,452	(60,635)	**(64,198)**	135,452	(60,635)
Manager's checks and demand drafts outstanding (Note 15)	**(154,698)**	330,087	(148,151)	**(154,698)**	330,087	(148,151)
Accrued taxes, interest and other expenses (Note 15)	**(2,465,494)**	1,536,192	406,092	**(2,418,672)**	1,468,654	476,346
Other liabilities (Note 15)	**2,693,824**	(188,190)	1,253,106	**2,522,176**	178,183	1,330,414
Proceeds from sale of ROPOA	**2,136,251**	2,412,488	1,854,649	**2,136,251**	2,412,488	1,854,649
Net cash generated from operations	**20,266,537**	18,301,594	13,197,527	**20,042,732**	17,352,172	14,931,642
Income taxes paid	**(480,314)**	(595,305)	(487,134)	**(342,010)**	(437,467)	(364,817)
Net cash provided by operating activities	**19,786,223**	17,706,289	12,710,393	**19,700,722**	16,914,705	14,566,825
CASH FLOWS FROM INVESTING ACTIVITIES						
Decrease (increase) in amounts of:						
Interbank loans receivables	**(2,346,334)**	–	–	**(2,346,334)**	–	–
Available-for-sale securities (Note 5)	**851,109**	(736,779)	(3,135,292)	**851,022**	(749,792)	(3,131,662)
Investments in bonds and other debt instruments (Note 5)	**(16,605,981)**	(5,898,488)	(2,013,977)	**(16,830,998)**	(4,651,987)	(2,231,488)
Investments in subsidiaries and associates	**43,031**	235,415	196,192	**111,499**	48,157	2,583
Proceeds from sale of investments in subsidiaries	**–**	100	–	**–**	100	–
Net disposal (acquisition) of bank premises, furniture and equipment (Note 7)	**(343,604)**	(111,322)	(298,791)	**(320,003)**	(291,434)	(236,272)
Net cash used in investing activities	**(18,401,779)**	(6,511,074)	(5,251,868)	**(18,534,814)**	(5,644,956)	(5,596,839)
CASH FLOWS FROM FINANCING ACTIVITIES						
Proceeds from (settlement of) bills and acceptances payable (Note 13)	**984,730**	547,733	(9,192,426)	**965,359**	202,619	(8,766,116)
Proceeds from subordinated debt (Note 14)	**3,000,000**	–	–	**3,000,000**	–	–
Net cash provided by (used in) financing activities	**3,984,730**	547,733	(9,192,426)	**3,965,359**	202,619	(8,766,116)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**5,369,174**	11,742,948	(1,733,901)	**5,131,267**	11,472,368	203,870
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR						
Cash and other cash items	**3,257,207**	2,581,883	2,940,933	**3,205,026**	2,581,027	2,940,306
Due from Bangko Sentral ng Pilipinas	**1,115,502**	3,313,537	2,197,775	**1,115,502**	3,313,537	2,197,775
Due from other banks	**5,807,556**	6,184,216	6,989,935	**5,142,524**	5,695,544	5,367,713
Interbank loans receivable	**13,785,136**	4,442,817	4,027,711	**13,742,241**	4,442,817	3,223,261
Securities held under agreements to resell	**5,400,000**	1,100,000	3,200,000	**5,400,000**	1,100,000	3,200,000
	29,365,401	17,622,453	19,356,354	**28,605,293**	17,132,925	16,929,055
CASH AND CASH EQUIVALENTS AT END OF YEAR						
Cash and other cash items	**3,342,672**	3,257,207	2,581,883	**3,342,466**	3,205,026	2,581,027
Due from Bangko Sentral ng Pilipinas	**3,765,737**	1,115,502	3,313,537	**3,765,737**	1,115,502	3,313,537
Due from other banks	**7,051,470**	5,807,556	6,184,216	**6,092,449**	5,142,524	5,695,544
Interbank loans receivable (Note 27)	**16,574,696**	13,785,136	4,442,817	**16,535,908**	13,742,241	4,442,817
Securities held under agreements to resell	**4,000,000**	5,400,000	1,100,000	**4,000,000**	5,400,000	1,100,000
	₱34,734,575	₱29,365,401	₱17,622,453	**₱33,736,560**	₱28,605,293	₱17,132,925

See accompanying Notes to Financial Statements.

1. General Information

Philippine National Bank (the Parent Company) was incorporated on February 4, 1916 and started commercial operations on July 22, 1916. ts principal place of business is at PNB Financial Center, President Diosdado Macapagal Boulevard, Pasay City. As of December 31, 2004 and 2003, the Parent Company is owned 44.98% by the Lucio Tan Group (LTG) and 44.98% by the National Government (NG). The Parent Company had 33,439 and 33,617 shareholders as of December 31, 2004 and 2003, respectively.

The Parent Company provides a full range of banking and other financial services to corporate, middle-market and retail customers, the NG, local government units (LGU's) and government-owned and controlled corporations (GOCC's) and various government agencies. The Parent Company's principal commercial banking activities include deposit-taking, lending, bills discounting, foreign exchange dealing, investment banking, fund transfers/remittance servicing and a full range of retail banking and trust services through its 324 domestic and 29 overseas branches and offices in 2004. The Parent Company's international subsidiaries have a network of 66 and 60 offices in 2004 and 2003, respectively, in key cities of the United States of America (USA), Canada, Western Europe, Middle East and Asia.

The Parent Company and its subsidiaries (the Group) are engaged in a number of diversified financial and related businesses such as merchant banking, remittance servicing, non-life insurance, leasing, stock brokerage, foreign exchange trading and related services. Certain affiliate of the Parent Company is also engaged in other services such as financing of small and medium-sized industries, life-insurance, as well as financial advisory services.

The number of employees of the Group follows:

	2004	2003
Group	**5,850**	5,790
Parent Company	**5,747**	5,442

The accompanying financial statements of the Group and of the Parent Company were authorized for issue by the Parent Company's board of directors (BOD) on April 8, 2005.

2. Restructuring and Rehabilitation

The Parent Company is currently operating under a rehabilitation program pursuant to the Memorandum of Agreement (MOA) signed by the Republic of the Philippines, the Philippine Deposit Insurance Corporation (PDIC) and the LTG on May 3, 2002.

Pursuant to the MOA, the following measures have been implemented:

(1) Capital Restructuring

i. The Parent Company instituted a capital reduction exercise as of December 31, 2001, reducing the par value of each of its common shares from ₱60 per share to ₱40 per share, resulting in a total capital reduction of ₱7.6 billion. This resulted in a decrease in the authorized capital stock of the Parent Company from ₱50.0 billion divided into 833,333,334 common shares to ₱33.3 billion divided into 833,333,334 common shares. The reduction in par value from ₱60 per share to ₱40 per share and the amendment to the articles of incorporation of the Parent Company were approved by the BOD of the Parent Company on May 17, 2002 and by the Securities and Exchange Commission (SEC) of the Philippines on July 23, 2002.

ii. On May 16, 2002, the Bangko Sentral ng Pilipinas (BSP) approved the following: (a) booking of an appraisal increment of ₱431.8 million for the year ended December 31, 2001 on branch premises and recognition of the same for the purpose of determining the Parent Company's capital adequacy ratio; and (b) booking of translation adjustment of ₱1.6 billion for the year ended December 31, 2001 representing the increase in peso value of the Parent Company's investment in foreign subsidiaries, for the purpose of the Rehabilitation Plan and as an exception to existing BSP regulations, provided that the same shall be excluded for dividend purposes.

iii. The translation adjustment of ₱1.6 billion was applied to eliminate the Parent Company's remaining deficit of ₱1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to ₱7.6 billion as a result of the capital reduction exercise. This corporate act was approved by the SEC on November 7, 2002, subject to the following conditions: (a) the remaining translation adjustment of ₱310.7 million as of December 31, 2001 (shown in the parent company financial statements as part of Capital Paid in Excess of Par Value) will not, without the prior approval of the SEC, be used or applied towards or make any provisions for losses that may be incurred in the future; and (b) for the purposes of declaration of dividends, any future surplus account of the Parent Company shall be restricted to the extent of the deficit wiped out by the translation adjustment.

The foregoing capital restructuring measures were aimed at reducing the deficit in the capital funds of the Parent Company which amounted to ₱8.9 billion as of December 31, 2001.

(2) Debt-to-Equity Conversion

In 2002, convertible preferred shares were issued to the PDIC as payment for the ₱7.8 billion borrowed by the Parent Company from the PDIC. This increased (i) the authorized capital stock of the Parent Company to ₱50.0 billion consisting of 1,054,824,557 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each and (ii) the issued capital stock of the Parent Company to ₱22.9 billion consisting of 378,070,472 common shares with a par value of ₱40 each and 195,175,444 convertible preferred shares with a par value of ₱40 each.

(3) Assignment of Certain Government Accounts to the PDIC

On July 30, 2002, the Parent Company and the PDIC signed an agreement whereby the Parent Company transferred and conveyed by way of "dacion en pago", or payment in kind, its rights and interests to the loans of the NG, certain LGU's, certain GOCC's and various government agencies and certain debt securities issued by various government entities (the Government accounts), to the PDIC. The "dacion en pago" arrangement reduced the Parent Company's outstanding obligations arising from the financial assistance given to the Parent Company by the BSP and the PDIC. The accrual of interest incurred by the Parent Company on the Government accounts and ₱10.0 billion payable to the PDIC ceased on October 1, 2001.

After the completion of the corporate actions and rehabilitation set out above (especially, the conversion of debt to equity and the "dacion en pago" arrangement), the balance of the Parent Company's outstanding obligations to the PDIC was ₱6.1 billion as of December 31, 2004 and 2003. This balance was restructured into a term loan of 10 years, with interest payable at 91-day treasury bills (T-bills) rate plus 1.00% (Note 13).

In line with the rehabilitation program of the Parent Company as approved under Monetary Board (MB) Resolution No. 626 dated April 30, 2003, the Parent Company and the BSP entered into a Memorandum of Understanding (MOU) on September 16, 2003. Pursuant to the MOU, the Parent Company shall comply to the full extent of its capability with the following directives of MB Resolution No. 649, among others:

(1) Maintain a strong management team supported by competent staff;
(2) Improve the Parent Company's past due ratio;
(3) Sell the PNB Financial Center;
(4) Dispose real and other properties owned or acquired (ROPOA); and
(5) Comply with certain prescribed limits.

The Parent Company is currently exerting efforts to comply with the aforementioned directives.

3. **Summary of Significant Accounting Policies**

Basis of Financial Statement Preparation and Consolidation

The Group follows the accounting principles generally accepted in the Philippines (Philippine GAAP) for the banking industry. The accompanying financial statements are prepared under the historical cost convention, except that as disclosed in the accounting policies described hereafter:

a) Trading account (TAS) and available-for-sale (ASS) securities are stated at fair value;

b) Parcels of land and buildings are carried at revalued amounts; and

c) Certain derivatives are measured at fair value.

The Group's financial statements consolidate the accounts of the Parent Company and the following wholly owned and majority owned subsidiaries:

Subsidiary	Industry	Country of Incorporation	Effective Percentage of Ownership
PNB Capital and Investment Corporation (PNB Capital)	Financial Markets	Philippines	100.00
PNB Forex, Inc.	- do -	- do -	100.00
PNB Holdings Corporation (PNB Holdings)	- do -	- do -	100.00
PNB Securities, Inc.	- do -	- do -	100.00
PNB Corporation - Guam	- do -	Guam	100.00
PNB International Investments Corporation	- do -	USA	100.00
PNB Europe PLC	- do -	United Kingdom	100.00
PNB International Finance Limited	- do -	Hong Kong	100.00
PNB Italy - SpA	- do -	Italy	100.00
PNB Remittance Center, Ltd.	Services	Hong Kong	100.00
Omicron Asset Portfolio (SPV-AMC), Inc.	Financial Markets	Philippines	100.00
Opal Portfolio Investments (SPV-AMC), Inc.	- do -	- do -	100.00
Tanzanite Investments (SPV-AMC), Inc.	- do -	- do -	100.00
Tau Portfolio Investments (SPV-AMC), Inc.	- do -	- do -	100.00
Japan - PNB Leasing and Finance Corporation (Japan - PNB Leasing)	- do -	- do -	60.00

Subsidiaries are consolidated when control is transferred to the Group or the Parent Company. Consolidation of subsidiaries ceases when control is transferred out of the Group or the Parent Company. The results of operations of a subsidiary disposed of are included in the statements of income until the date of disposal when the Group or Parent Company ceases to have control of the subsidiary.

Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. The financial statements of the Parent Company and its subsidiaries are combined on a line-by-line basis after eliminating material intercompany transactions.

Minority interest represents the interest in Japan - PNB Leasing not held by the Parent Company. The minority interest component in the consolidated financial statements, not being material in amount, is shown as part of Other Liabilities and Miscellaneous Expenses.

The accompanying parent company financial statements reflect the accounts maintained in the Regular Banking Unit (RBU) and Foreign Currency Deposit Unit (FCDU). The financial statements individually prepared for these units are combined after eliminating inter-unit accounts.

The preparation of financial statements in accordance with Philippine GAAP requires the Group to make estimates and assumptions that affect the reported amounts of resources, liabilities, income and expenses, and disclosure of contingent resources and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effect of any change in estimates will be reflected in the financial statements when reasonably determinable.

Changes in Accounting Policies

On January 1, 2004, the following new accounting standards became effective and were adopted by the Group:

- Statement of Financial Accounting Standards (SFAS) 12/International Accounting Standard (IAS) 12, Income Taxes, requires deferred income taxes to be determined using the balance sheet liability method. The adoption of this accounting standard resulted in a retroactive upward adjustment to deficit as of December 31, 2003 and 2002 amounting to ₱.7 billion and ₱1.5 billion, respectively, and recognition of deferred tax liability provided on the revaluation increment on land and buildings and unrealized gain on ASS amounting to ₱606.2 million and ₱667.6 million as of December 31, 2004 and 2003, respectively. Net income decreased by ₱136.5 million in 2003 and net loss increased by ₱1.8 billion in 2002 (Note 25).

- SFAS 17/IAS 17, *Leases,* prescribes the accounting policies and disclosures applicable to finance and operating leases. The adoption of the standard resulted in the recognition of lease payments under operating leases on a straight-line basis. Previously, all leases under operating lease are recognized in the statements of income on the basis of the terms of the lease agreement. The adoption of this accounting standard resulted in a retroactive upward adjustment to deficit as of December 31, 2003 and 2002 amounting to ₱47.0 million and ₱67.1 million, respectively. Net income increased by ₱20.1 million in 2003 and net loss decreased by ₱8.2 million in 2002 (Note 25).

Additional disclosures required by the new standards were included in the financial statements, where applicable.

New accounting standards based on IAS and International Financial Reporting Standards (IFRS), referred to as Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS), respectively, will become effective in 2005. The Group will adopt the following new accounting standards effective January 1, 2005:

- PAS 19, *Employee Benefits*, provides for the accounting for long-term and other employee benefits. The standard requires the use of projected unit credit method in determining the retirement benefits of the employees and a change in the manner of computing benefit expense relating to past service cost and actuarial gains and losses. It requires the Group to determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the statement of condition dates.

  The Group has commissioned an independent actuary to do an actuarial valuation study of its retirement liability under PAS 19. Pending the completion of such study, the Group is unable to determine the impact of PAS 19 on the financial statements.

- PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions,* provides for the required disclosure and presentation in respect of the accounts of banks and similar financial institutions. It also provides that provision for general banking risks is treated as appropriation of surplus and should not be included in the determination of net income for the period. The Group has yet to determine the effect of this standard in the context of the need to reallocate the general reserve to cover any increase in specific loan loss reserves required under PAS 39 (see discussion on PAS 39). The required new disclosures will be reflected in the financial statements, where applicable.

- PAS 32, *Financial Instruments: Disclosure and Presentation*, covers the disclosure and presentation of all financial instruments. The standard requires more comprehensive disclosures about the Group's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include terms and conditions of financial instruments used by the Group, types of risks associated with both recognized and unrecognized financial instruments (market risk, price risk, credit risk, liquidity risk, and cash flow risk), fair value information of both recognized and unrecognized financial assets and financial liabilities, and the Group's financial risk management policies and objectives. The standard also requires financial instruments to be classified as liabilities or equity in accordance with its substance and not its legal form.

- PAS 39, *Financial Instruments: Recognition and Measurement*, establishes the accounting and reporting standards for recognizing and measuring the Group's financial assets and financial liabilities. The standard requires a financial asset or financial liability to be recognized initially at fair value. Subsequent to initial recognition, the Group should continue to measure financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are measured at cost or amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at cost or amortized cost, except for liabilities classified as "at fair value through profit and loss" and derivatives, which are subsequently measured at fair value.

  PAS 39 also covers the accounting for derivative instruments. The standard has expanded the definition of a derivative instrument to include derivatives (derivative-like provisions) embedded in non-derivative contracts. Under the standard, every derivative instrument is recorded in the statements of condition as either an asset or liability measured at its fair value. Derivatives that are not hedges are adjusted to fair value through income. If a derivative is designated and qualifies as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in capital funds until the hedged item is recognized in income. The Group must formally document, designate, and assess the effectiveness of derivative transactions that receive hedge accounting treatment.

  The Group has established a task force that will implement the provisions of PAS 32 and PAS 39 and assess the implications of these standards to the Group's financial statements. Although the task force has already undertaken specific steps/activities towards the Group's compliance with the standards, to date, the Group has not yet determined the impact on the financial statements due to the following reasons:

  - The Group is still in the process of formalizing its policies, systems, and processes related to the adoption of these standards.

  - The system which will incorporate the requirements of PAS 32 and PAS 39 has not yet been implemented. The BSP, through MB Resolution No. 1869 dated December 23, 2004, has given the banks and financial institutions until December 31, 2005 to set up their infrastructures to be compliant with PAS 32 and PAS 39. Interim reports that will be submitted to the BSP for 2005 need not be in compliance with the provisions of the said standards.

On the impact of account classification and related measurement, the Group has already submitted to the BSP the proposed reclassification of its trading and investment securities portfolio. The Group does not expect any material impact on the classification of financial assets and liabilities.

Once the task force has completed the implementation of the provisions of the PAS 32 and PAS 39 and the existing systems has been reconfigured to adopt the effective interest rate method of amortization, the Group will quantify the effect of adopting the effective interest rate method in measuring amortized cost for loans, investments in bonds and other debt instruments (IBODI) and ASS. Due to the volume of transactions, it is impracticable to compute for the financial impact manually. The Group will report the financial implication as soon as the information becomes available.

PAS 39 requires that in the absence of quoted market rates, the discounted cash flow method will be used in determining whether an asset is impaired. The effect of adopting this provision will not be material to the financial assets and liabilities of the Group, except for the impairment of loans and other receivables. Currently, the adequacy of allowance for probable losses on loans and other receivables is determined based on management criteria and BSP requirements. The Group is in the process of establishing a system of identifying loans that show indications of impairment and therefore subject to impairment test through the discounted cash flow method. Pending the completion of such process, the Group is unable to determine the extent of the impairment loss on its loan portfolio and the impact on the financial statements.

Currently, the Group does not intend to adopt hedge accounting. Starting 2005, the Group will follow fair value valuation for all its derivatives transactions. The effect of adopting fair valuation method is not material to the financial statements.

In general, the effect of adopting these standards will not result in a restatement of prior years' financial statements as allowed by the SEC. Any cumulative effect of adopting the standards, however, will be charged against surplus beginning. The disclosures required by PAS 32 will be reflected in the 2005 financial statements, where applicable.

- PAS 40, *Investment Property*, prescribes the accounting treatment for investment property and related disclosure requirements. This standard permits the Group to choose either the fair value model or cost model in accounting for investment property. Fair value model requires an investment property to be measured at fair value with fair value changes recognized directly in the statements of income. Cost model requires that an investment property should be measured at depreciated cost less any accumulated impairment losses. Regardless of valuation model (either cost or fair value), the adoption of PAS 40 may result in an adjustment of prior years' financial statements. The Group is still in the process of identifying ROPOA accounts that will be accounted for under PAS 40 and PFRS 5 (see significant provisions of PFRS 5), and which valuation model to be used under PAS 40. Accordingly, the Group has not yet quantified the implications of PAS 40 and PFRS 5 on its financial statements. The Group will report the financial statements implications of PAS 40 and PFRS 5 as soon as the information becomes available.

- PFRS 4, *Insurance Contract,* specifies the financial reporting for all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. The more salient provisions of Phase 1 of the standard which will be effective January 1, 2005 are the following: (a) it requires an insurer to unbundle (i.e., account separately) deposit component of some insurance contracts to avoid omission of assets and liabilities from its statements of condition; (b) it eliminates catastrophe and equalization provisions; (c) it requires a test for adequacy of recognized insurance liabilities and an impairment test for reinsurance assets; and (d) it requires an insurer to keep insurance liabilities in its statements of condition until they are discharged, cancelled or expired, and to present insurance liabilities without offsetting them against related reinsurance assets. The required disclosures of the standard are as follows: (a) the amounts in the insurer's financial statements that arise from the insurance contracts; and (b) the estimated amount, timing and uncertainty of future cash flows from insurance contracts. The requirement to disclose the fair value of insurance liabilities and insurance assets is part of Phase 2 of the standard which will be effective on January 1, 2007.

- PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations,* specifies the accounting for assets held for sale and the presentation and disclosure of discontinued operations. It requires assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and the depreciation on such assets to cease. Furthermore, assets that meet the criteria to be classified as held for sale should be presented separately on the face of the statements of condition and the results of discontinued operations to be presented separately in the statements of income. Pending the identification of the ROPOA accounts to be accounted for under PFRS 5, as discussed under PAS 40, the effect of adoption of PFRS 5 with respect to the assets to be accounted for under this standard will not be material to the financial statements of the Group.

The Group will also adopt in 2005 the following revised standards:

- PAS 1, *Presentation of Financial Statements,* provides a framework within which an entity assesses how to present fairly the effects of transactions and other events; provides the base criteria for classifying liabilities as current or noncurrent; prohibits the presentation of income from operating activities and extraordinary items as separate line items in the statements of income; and specifies the disclosures about key sources of estimation uncertainty and judgments that management has made in the process of applying the entity's accounting policies. It also requires changes in the presentation of minority interest in the statements of condition and statements of income.

- PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* removes the concept of fundamental error and the allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors. It defines material omissions or misstatements, and describes how to apply the concept of materiality when applying accounting policies and correcting errors.

- PAS 10, *Events After the Balance Sheet Date,* provides a limited clarification of the accounting for dividends declared after the statement of condition date.

- PAS 16, *Property, Plant and Equipment,* provides additional guidance and clarification on the recognition and measurement of items of property, plant and equipment. It also provides that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

- PAS 17, *Leases,* provides a limited revision to clarify the classification of a lease of land and buildings and prohibits expensing of initial direct costs in the financial statements of lessors.

- PAS 24, *Related Party Disclosures,* provides additional guidance and clarity in the scope of the standard, the definitions and the disclosures for related parties. It also requires disclosure of the compensation of key management personnel by benefit type.

- PAS 27, *Consolidated and Separate Financial Statements,* reduces alternatives in accounting for subsidiaries in the consolidated financial statements and in accounting for investments in the separate financial statements of a parent company, venturer or investor. Investments in subsidiaries will be accounted for either at cost or in accordance with PAS 39 in the separate financial statements. Equity method of accounting will no longer be allowed in the separate financial statements. This standard also requires strict compliance with the adoption of uniform accounting policies and requires the parent company to make appropriate adjustments to the subsidiary's financial statements to conform them to the parent company's accounting policies for reporting like transactions and other events in similar circumstances.

- PAS 28, *Investments in Associates*, reduces alternatives in accounting for associates in the consolidated financial statements and in accounting for investments in the separate financial statements of an investor. Investments in associates will be accounted for either at cost or in accordance with PAS 39 in the separate financial statements. Equity method of accounting will no longer be allowed in the separate financial statements. This standard also requires strict compliance with adoption of uniform accounting policies and requires the investor to make appropriate adjustments to the associate's financial statements to conform them to the investor's accounting policies for reporting like transactions and other events in similar circumstances.

The Group does not expect any significant impact of the adoption of the foregoing revised accounting standards except for the impact of adopting the cost method in accounting for investments in subsidiaries and associates in the parent company financial statements, which is expected to decrease both the carrying amounts of investments and total capital funds by ₱3.7 billion as of December 31, 2004 equivalent to the undistributed retained earnings and other equity adjustments of said investees. However, the investment shall be subject to annual review for impairment. In circumstances when there is impairment, the carrying value shall be written down to recoverable amount. The disclosures required by these revised PAS will be reflected in the 2005 financial statements, where applicable.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, amounts due from BSP and other banks, interbank loans receivable and securities held under agreements to resell with maturity of three months or less from dates of placement and which are subject to insignificant risk of changes in value.

Securities Held Under Agreements to Resell

Resale agreements are contracts under which a party purchase securities and simultaneously agrees to resell the same securities at a specified future date at a fixed price. Securities purchased under resale agreements (reverse repos) are recorded as securities purchased under agreements to resell. The amounts advanced under resale agreements are carried in the statements of condition at the principal amount advanced. Accrued interest is included in Other Resources in the statements of condition. Interest earned on such agreements is reported as Interest Income in the statements of income.

Trading and Investment Securities

TAS consisting of government and private debt securities are purchased and held principally with the intention of selling them in the near term. These securities are carried at fair market value; realized and unrealized gains and losses on these instruments are recognized in Trading and Investment Securities Gains - Net in the statements of income. Interest earned on debt instruments is reported as Interest Income. Quoted market prices, when available, are used to determine the fair value of trading instruments. If quoted market prices are not available, then fair values are estimated using quoted price of instruments with similar characteristics and risks, or using discounted cash flow technique.

When a security is transferred from TAS, the unrealized gain or loss at the date of transfer already recognized in the statements of income shall not be reversed. When a security is transferred into TAS, the unrealized holding gain or loss at the date of transfer is recognized in the statements of income immediately.

Securities are classified as ASS when purchased and held indefinitely, i.e., neither held to maturity nor for trading purposes, where the Group anticipates to sell in response to liquidity requirements or in anticipation of changes in interest rates or other factors.

When a debt security is transferred into ASS from IBODI, the unrealized gain or loss at the date of the transfer shall be excluded from the reported income and reported as a separate component of capital funds in the statements of condition until realized.

Underwriting Accounts (UA) are available-for-sale underwritten debt and equity securities purchased and held principally with the intention of selling them within a defined short-term period. ASS and UA are carried at fair market value; unrealized gains and losses are excluded from the reported income and are reported as a separate component of capital funds in the statements of condition.

IBODI are debt securities where the Group has the positive intent and ability to hold to maturity. These securities are carried at amortized cost; amortization of premium or accretion of discount is included in Interest Income in the statements of income; realized gains and losses are included in Trading and Investment Securities Gains - Net in the statements of income. The allowance for probable losses is established by a charge against income to reflect other-than-temporary impairments in value. Under current bank regulations, IBODI shall not exceed 50.00% of adjusted statutory net worth plus 40.00% of total deposit liabilities.

When a debt security is transferred from ASS and UA to IBODI, the unrealized gain or loss at the date of the transfer is maintained as a separate component of capital funds and is amortized over the remaining life of the security as an adjustment of the yield in a manner consistent with the amortization of the premium or accretion of discount.

Receivables from Customers and Allowance for Probable Losses

Receivables from customers are stated at the outstanding principal balance, reduced by unearned discounts, other deferred income, capitalized interest, and allowance for probable losses.

Receivables from customers are classified as nonaccruing or nonperforming in accordance with BSP regulations, or when, in the opinion of management, collection of interest or principal is doubtful. At the time the receivable is classified as nonaccruing, interest previously recorded but not collected is provided with an allowance for probable losses. Receivables from customers are not reclassified as accruing until interest and principal payments are brought current or the receivables are restructured in accordance with existing BSP regulations, and future payments appear assured.

The allowance for probable losses, which comprises both specific and general loss reserves, is the estimated amount of losses in the Group's loan portfolio based on management's evaluation of the collectibility of the loans, after consideration of prevailing and anticipated economic conditions, collection and credit experience with specific accounts, fair market value of collateral, financial capabilities of guarantors, present value of future cash collections and evaluations made by the BSP. The BSP observes certain criteria and guidelines based largely on the classification of loans in establishing specific loss reserves. To supplement the specific loan loss reserves, a general reserve on unclassified loan is set aside.

The allowance for probable losses is established through provisions for probable losses charged against current operations. Loans are written off against the allowance for probable losses when management believes that the collectibility of the principal is unlikely.

Receivables arising from transactions with credit cardholders are provided with allowance for probable losses based on the review and evaluation of the status of the receivables from cardholders and guidelines issued by the BSP. The MB through BSP Circular No. 398 issued on August 21, 2003 provides general guidelines governing credit card operations, including the minimum credit card receivable classification requirement as follows:

No. of Days Past Due	Classification	Percentage of Allowance
91 – 120	Substandard	25%
121 – 180	Doubtful	50%
181 or more	Loss	100%

Investments in Subsidiaries and Associates

Investments in subsidiaries and associates are accounted for under the equity method in the parent company financial statements and are carried in the statements of condition at cost plus post-acquisition changes in the Group's share in the net resources of the subsidiaries and associates, less any impairment in value. Post-acquisition changes include the share in the subsidiaries' and associates': (a) income or losses, (b) revaluation increment in properties, and (c) unrealized gain or loss on investment securities. Dividends received are treated as a reduction in the carrying values of the investments. Equity in revaluation of properties and unrealized gain or loss on investment securities of subsidiaries and associates are shown as separate components of capital funds in the statements of condition. Unrealized gains arising from transactions with subsidiaries and associates are eliminated to the extent of the interest in the subsidiaries and associates against the Investments in Subsidiaries and Associates account. Unrealized losses are eliminated similarly but only to the extent that there is no evidence of impairment of the resources transferred. When the Parent Company's share in the net losses of the subsidiary exceeds the carrying amount of the investment and the Parent Company guarantees the obligations of the subsidiary or otherwise commits to provide further financial support to the subsidiary, such excess shall be recognized by the Parent Company as a liability.

Financial statements of foreign consolidated subsidiaries that are not integral to the operations of the Group are translated at year-end exchange rates with respect to the statements of condition, and at the average exchange rates for the year with respect to the statements of income accounts. Resulting translation differences are included in the capital funds as Translation Adjustment. On disposal of a foreign entity, accumulated exchange differences are recognized in the statements of income as a component of the gain or loss on disposal included in Miscellaneous Income in the statements of income.

Investments in subsidiaries and associates held with a view to its subsequent disposal are classified as noncurrent available-for-sale investments. These investments are accounted for under the cost method. The carrying amount of the investment in subsidiaries is written down to its fair market value based on any significant and apparent permanent decline in value of the investment in subsidiaries, as indicated by a series of operating losses of an investee or other factors.

Under BSP regulations, the use of the equity method of accounting for investments in shares of stock is allowable only where ownership is more than 50.00%. The use of the equity method of accounting for equity interest of 20.00% to 50.00% is being made for financial reporting purposes in accordance with Philippine GAAP and is not intended for BSP reporting purposes.

Other equity investments where the Group has no significant influence are carried at cost less allowance for probable losses. The allowance for probable losses is set up by a charge against income included in Provision for Probable Losses in the statements of income.

<u>Bank Premises, Furniture and Equipment</u>
The Group's depreciable properties, including leasehold improvements, furniture, fixtures, and equipment but excluding buildings are stated at cost less accumulated depreciation and any impairment in value.

The initial cost of bank premises, furniture and equipment consists of its construction cost or purchase price including import duties, taxes and any directly attributable costs of bringing the asset to its working condition or location for its intended use. Expenditures incurred after the bank premises, furniture and equipment been put into operation, such as repairs and maintenance are normally charged against operations in the year in which costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of bank premises, furniture and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of bank premises, furniture and equipment. When bank premises, furniture and equipment are retired or otherwise disposed of, the cost and the related accumulated depreciation and amortization are removed from the accounts, and any resulting gain or loss is credited to or charged against current operations.

Borrowing costs that are directly attributable to the construction of bank premises are capitalized during the construction period.

Land are stated at appraised values less any impairment in value while buildings are stated at appraised values less accumulated depreciation and any impairment in value. The appraised values as of December 31, 2004 and 2003 were determined by independent firms of appraisers in March 2004. The appraisal increment resulting from the revaluation which amounted to ₱419.7 million in 2003 was credited to Revaluation Increment on Land and Buildings shown as a separate component of capital funds in the statements of condition. Appraisal increment on buildings is depreciated over the estimated remaining lives of the buildings.

Depreciation and amortization is computed using the straight-line method over the following estimated useful life of the respective resources:

	Useful Life in Years
Buildings	25 - 50
Furniture, fixtures and equipment	5
Leasehold improvements	Shorter of the estimated useful lives of the improvements or the terms of the related leases which range from 3 to 10 years.

The useful life and the depreciation and amortization method are reviewed periodically to ensure that the period and the method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of bank premises, furniture and equipment.

The carrying values of the bank premises, furniture and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, an impairment loss is recognized in the statements of income.

Real and Other Properties Owned or Acquired

Resources acquired by the Group in settlement of receivables from customers are stated at the total outstanding loan exposure at the time of foreclosure or bid price, whichever is lower, less allowance for probable losses and any impairment in value. Nonrefundable taxes such as capital gains tax and documentary stamp tax that were paid by the Parent Company and its subsidiaries to effect the foreclosure are capitalized provided that the adjusted value of the foreclosed asset does not exceed its net realizable value. Security, maintenance and other foreclosure-related expenses subsequent to the foreclosure or acquisition of the properties are charged against current operations as incurred. Allowance for probable losses is set up based on BSP provisioning requirement and for any anticipated significant shortfalls from the recorded values to the net realizable values determined by an independent firm of appraisers and/or by current negotiations and programs to dispose of these properties to interested parties including estimated selling costs.

Income Taxes

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

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward of unused MCIT and unused NOLCO can be utilized. Deferred income tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries, associates and interests in joint ventures. With respect to investments in foreign subsidiaries, associates and interests in joint ventures, deferred tax liabilities are recognized except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred income tax assets is reviewed at each statement of condition date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Deferred income tax assets and liabilities are measured at the tax rates that are applicable 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 statement of condition date.

Impairment of Assets

An assessment is made at each statement of condition date to determine if there is any indication of impairment of any asset, or if there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated at the higher of the asset's value in use or its net selling price.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income and expense account in the period in which it arises, unless the asset is carried at a revalued amount in which case the impairment loss is charged against the revaluation increment of the said asset.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation and amortization) had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is credited to current operations, unless the asset is carried at a revalued amount in which case the reversal of the impairment loss is credited to the revaluation increment of the said asset.

Foreign Exchange Transactions and Translation

Resources and liabilities of the RBU denominated in foreign currencies are translated to Philippine pesos at prevailing Philippine Dealing System weighted average rate (PDSWAR) at the end of the year. Income and expense items are translated at rates at transaction dates.

For financial reporting purposes, the accounts of the FCDU, which are maintained in US dollars, are translated into their equivalents in Philippine pesos based on the PDSWAR prevailing at the end of the year (for resources and liabilities) and at the average PDSWAR for the year (for income and expenses).

Foreign exchange differentials arising from foreign currency transactions and restatements of foreign currency-denominated resources and liabilities are credited to or charged against operations in the year in which the rates change.

Revenue 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 must also be met before revenue is recognized:

Interest Income
Interest income on nondiscounted receivables from customers is recognized based on the accrual method of accounting, except in the case of nonperforming receivables in accordance with BSP regulations. Interest income on these nonperforming receivables is recognized only upon actual collection. Loan fee income that represents an adjustment of yield on respective loans, if any, is included in Interest Income in the statements of income.

Unearned discounts are recognized as income over the terms of the receivables.

Capitalized interest income on restructured loans is deferred and shown as deduction from Receivables from Customers. Capitalized interest is amortized to income based on collections.

Interest on penalties on past due credit card receivables are recognized as a credit to Deferred Credits included in Miscellaneous Liabilities in the statements of condition. Deferred Credits are amortized to income based on collections.

Interest on securities held under agreements to resell and investment securities are recognized as the interest accrues, taking into account the effective yield on the asset.

Loan Fees and Service Charges
Loan commitment fees are recognized as earned over the terms of the credit lines granted to each borrower. Loan syndication fees are recognized upon completion of all syndication activities and where the Parent Company does not have further obligations to perform under the syndication agreement.

Service charges and penalties are recognized only upon collection or accrued where there is reasonable degree of certainty as to its collectibility.

Leasing Income
Japan - PNB Leasing's income from equipment leasing is recognized based on the finance lease method of accounting and is included in Miscellaneous Income in the statements of income. Under the financing method, the aggregate rentals are recorded as lease contracts receivable reported under the Receivables from Customers account in the statements of condition with a corresponding credit to the cost of equipment for lease account. The excess of aggregate rentals over the cost of the leased equipment (reduced by the estimated residual value at the termination of the lease) is taken up as unearned lease income to be amortized over the term of the lease based on the effective interest rate method. Residual values represent estimated proceeds from the disposition of equipment at the time the lease is terminated and included in Receivables from Customers in the statements of condition. Unearned lease income cease to be amortized when receivables become over 90 days past due. Financing income on nonaccruing receivables is recognized only to the extent of cash collections received.

Premium Revenue
Premiums from short duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method. The portion of the premiums written that relates to the unexpired period of the policies at the statement of condition dates is accounted for as a Reserve for Unearned Premiums and included in Other Liabilities in the statements of condition. The related reinsurance premiums ceded that pertain to the unexpired periods at statement of condition dates are accounted for as Deferred Reinsurance Premiums and included in Other Resources in the statements of condition. The net changes in these accounts between statement of condition dates are credited to or charged against current operations.

Gain from Sale of ROPOA
For cash sale, the entire gain from the sale (excess of selling price over carrying value) of property is recognized as gain from sale of ROPOA (included in Miscellaneous Income in the statements of income) during the year. For installment sales, under which the consideration is receivable in installments, the revenue is recognized under the installment method. Under the installment method, each collection consists partly of recovery of cost and partly of recovery of gross profit in the same ratio that these two elements existed at the original sale. The gain recognized on the cash collections is based on the percentage of total income to total sales price. Deferred gross income is shown as a deduction from Sales Contract Receivable included in Other Resources in the statements of condition.

Retirement Costs
The Parent Company and certain subsidiaries operate a number of defined plans, the resources of which are generally held in a separate trustee-administered funds. The retirement benefit plans are generally funded by the relevant Group companies, taking into account the recommendations of independent qualified actuaries.

The Parent Company's and certain subsidiaries' retirement costs are actuarially determined using the projected unit credit method. This method reflects the services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, interest on unfunded actuarial liability experience adjustments, and actuarial gains (losses) amortized over the average of the expected remaining working lives of the covered employees.

Leases
Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged against income.

Capitalized leased assets are depreciated over the shorter of the estimated useful lives of the assets or the respective lease terms.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease expenses are charged against current operations on a straight-line basis over the lease term.

Derivative Instruments
The Parent Company is a party to interest rate swap and foreign exchange forward contracts. These contracts are entered into as a means of reducing or managing its foreign exchange and interest rate exposures.

Realized and unrealized gains and losses on derivatives designated and qualified as hedges are deferred and recognized as income or expense over the terms of the hedged instruments. Realized and unrealized gains and losses on such contracts that are not designated as hedges are recognized currently as income or expense. Interest rate swap is carried at fair market value with the corresponding change in fair market value recognized in the statements of income. The differentials paid or received under an interest rate swap agreement are recognized as Interest Expense in the statements of income.

Provisions and Contingencies
Provisions are recognized when an obligation (legal or constructive) is incurred as a result of a past event and where it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as Interest Expense in the statements of income.

Contingent liabilities are not recognized but are disclosed in the financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized but are disclosed in the financial statements when an inflow of economic benefits is probable.

Earnings (Loss) per Share
Basic earnings (loss) per share is computed based on the weighted average number of common shares outstanding after giving retroactive effect to stock dividends declared, stock rights exercised and stock splits. Diluted earnings (loss) per share is computed based on the weighted average number of common shares outstanding, adjusted for the effect of dilutive preferred shares, after giving retroactive effect to stock dividends declared, stock rights exercised and stock splits.

Subsequent Events
Post year-end events that provide additional information about the Group's position at the statement of condition date (adjusting events) are reflected in the financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the financial statements when material.

4. Trading Account Securities

This account consists of:

	Group		Parent Company	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
Government securities - net of unrealized loss for decline in value of ₱9.7 million in 2004 and ₱0.4 million in 2003	**₱712,229**	₱909,441	**₱712,229**	₱909,441
Other debt securities - inclusive of unrealized gain of ₱6.9 million in 2004 and ₱1.3 million in 2003 for the Group	**42,474**	93,014	**–**	56,458
	₱754,703	₱1,002,455	**₱712,229**	₱965,899

The breakdown of TAS by contractual maturity follows:

	Group		Parent Company	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
Due within one year	**₱575,147**	₱128,912	**₱570,466**	₱123,262
Due beyond one year	**179,556**	873,543	**141,763**	842,637
	₱754,703	₱1,002,455	**₱712,229**	₱965,899

5. Investment Securities

	Group		Parent Company	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
ASS				
Government securities, at fair market value	**₱4,114,884**	₱4,990,476	**₱4,114,884**	₱4,990,476
Other debt securities, at fair market value	**199,310**	445,341	**196,119**	442,063
	4,314,194	5,435,817	**4,311,003**	5,432,539
IBODI				
Government securities, at amortized cost	**53,545,167**	40,329,580	**51,665,567**	38,403,846
Zero-interest coupon notes - net of allowance for probable losses of ₱259.8 million (Note 11)	**3,771,805**	–	**3,771,805**	–
Other debt securities, at amortized cost - net of allowance for probable losses of ₱267.6 million in 2004 and ₱201.7 million in 2003 (Note 11)	**1,402,682**	1,561,371	**1,182,184**	1,161,990
	58,719,654	41,890,951	**56,619,556**	39,565,836
	₱63,033,848	₱47,326,768	**₱60,930,559**	₱44,998,375

Unrealized loss on ASS amounted to ₱143.5 million (including ₱4.7 million of subsidiaries) and ₱138.8 million as of December 31, 2004 for the Group and Parent Company, respectively, and unrealized gain on ASS amounted to ₱127.0 million (net of unrealized loss of ₱4.6 million of subsidiaries) and ₱131.6 million as of December 31, 2003 for the Group and Parent Company, respectively.

As of December 31, 2004, the zero-interest coupon notes represent investments in Global Ispat Holdings, Inc. (GIHI) and Global Steelworks International, Inc. (GSII) which assumed the liabilities of National Steel Corporation (NSC) (Note 6).

On October 15, 2004, GIHI and GSII, Special Purpose Vehicle (SPV) companies, and the NSC Creditors entered into an agreement which sets forth the terms and conditions upon which the NSC Creditors have agreed to accept zero-interest coupon notes in the aggregate amount of ₱12.3 billion to be issued by the SPV companies in settlement of the liabilities of NSC.

The zero-interest coupon notes were issued in two tranches namely: (a) Tranche A Note in the principal amount of ₱2.0 billion and (b) Tranche B Note in the principal amount of ₱10.3 billion, which notes are secured by a first ranking mortgage and security interest over the NSC plant assets and stand-by letter of credit by the SPV companies in accordance with the schedule in the agreement amounting to US$4.5 million and matures on October 21, 2005.

On October 15, 2004, the Parent Company received Tranche A Note at the principal amount of ₱803.5 million and Tranche B Note at the principal amount of ₱3.4 billion in exchange for the outstanding receivable from NSC of ₱5.3 billion. The zero-interest coupon notes with an outstanding balance of ₱3.8 billion as of December 31, 2004, net of additional cash payment of ₱140.3 million and allowance for probable losses of ₱259.8 million, covered by Tranche A and Tranche B are payable in five years and eight years, respectively. Using a discount rate of 13.24%, the present value of such notes amounts to ₱1.9 billion. Such difference as of December 31, 2004 of ₱1.9 billion was deferred over a ten-year period in accordance with regulatory accounting policies prescribed by the BSP for banks and non-bank financial institutions availing of the provisions of Republic Act (RA) No. 9182, *The Special Purpose Vehicle Act of 2002.*

In 2004, the Parent Company set aside ₱259.8 million allowance for probable losses on such notes instead of the BSP required allowance of ₱105.0 million. The excess allowance for probable losses of ₱154.8 million fully covers the BSP required allowance of ₱55.0 million for the deferred loss on sale of ₱1.1 billion shown under Deferred Charges in Other Resources (Note 10).

Had the Parent Company carried such notes at its present value as required by generally accepted accounting principles, IBODI and Deficit as of December 31, 2004 would have been decreased and increased, respectively, by ₱1.9 billion and net income in 2004 would have been decreased by the same amount.

The breakdown of investment securities by contractual maturity follows:

	Group					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
			(In Thousand Pesos)			
ASS	**₱915,778**	**₱3,398,416**	**₱4,314,194**	₱229,453	₱5,206,364	₱5,435,817
IBODI - at gross	**11,384,993**	**47,862,082**	**59,247,075**	9,115,907	32,976,789	42,092,696
	₱12,300,771	**₱51,260,498**	**₱63,561,269**	₱9,345,360	₱38,183,153	₱47,528,513

	Parent Company					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
			(In Thousand Pesos)			
ASS	**₱915,778**	**₱3,395,225**	**₱4,311,003**	₱229,453	₱5,203,086	₱5,432,539
IBODI - at gross	**11,110,004**	**46,036,973**	**57,146,977**	8,797,923	30,969,658	39,767,581
	₱12,025,782	**₱49,432,198**	**₱61,457,980**	₱9,027,376	₱36,172,744	₱45,200,120

IBODI also includes the following securities:

a. Twelve-year peso-denominated bonds with face value amounting to ₱11.2 billion as of December 31, 2004 and 2003. These bonds, with an original amount of ₱24.3 billion, were issued by the NG in settlement of the Parent Company's claims as discussed in Note 10. These bonds, which will mature in 2007, are eligible as part of the liquidity cover requirements on government deposits. These bonds were redeemable at any time at the option of the NG and were originally issued as nontransferable until the lifting of such restriction in 1997. In February 1998, ₱10.0 billion of these bonds were sold with an agreement to swap interest payments based on the average 91-day and 364-day T-bill rates during the three-month period preceding the annual repricing date for the remaining term of the bonds. As of December 31, 2004 and 2003, IBODI includes ₱0.8 billion and ₱1.2 billion, respectively, of bonds pledged to secure performance for the estimated net interest differential under the interest rate swap agreement. As of December 31, 2004 and 2003, the fair market value of the interest rate differential on the swap agreement, representing the net present value of interest differential that the Parent Company has to pay the counterparty, amounted to ₱262.1 million and ₱447.9 million, respectively.

b. Bonds issued by Philippine Sugar Corporation (PSC) amounting to ₱2.8 billion. The bonds carry an annual interest rate of 4.00% and will mature in 2014. The full repayment of principal and accumulated interest to maturity is guaranteed by a sinking fund managed by the Parent Company's Trust Banking Group (TBG). As of December 31, 2004, the net asset value of the sinking fund amounted to ₱2.8 billion earning an average rate of return of 9.44% per annum. Management expects that the value of the sinking fund in the year 2014 will be more than adequate to cover the full redemption value of PSC bonds.

The annual interest rates ranged from 2.00% to 10.00% in 2004 and from 1.94% to 10.00% in 2003 for foreign currency-denominated IBODI, and from 4.00% to 15.00% in 2004 and from 4.00% to 21.00% in 2003 for peso-denominated IBODI. As of December 31, 2004 and 2003, the market value of IBODI approximates its carrying value.

6. **Receivables from Customers**

This account consists of:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Loans and discounts	**₱65,208,588**	₱72,858,473	**₱64,197,772**	₱71,940,144
Customers' liabilities on acceptances, letters of credit and trust receipts	**3,225,426**	4,034,563	**3,225,426**	4,034,563
Bills purchased	**2,139,659**	989,065	**2,139,659**	989,065
Credit card accounts	**1,021,588**	936,428	**1,021,588**	936,428
Lease contracts receivable	**952,270**	793,047	**–**	–
Premiums receivable	**400,970**	294,141	**–**	–
Residual value of leased equipment	**138,252**	101,623	**–**	–
	73,086,753	80,007,340	**70,584,445**	77,900,200
Unearned discount and lease income	**(117,045)**	(80,608)	**(7,555)**	(9,008)
Capitalized interest on restructured loans	**(1,108,709)**	(1,759,391)	**(1,108,709)**	(1,759,391)
Allowance for probable losses (Note 11)	**(15,709,391)**	(18,127,028)	**(15,466,145)**	(17,926,497)
	₱56,151,608	₱60,040,313	**₱54,002,036**	₱58,205,304

As of December 31, 2004 and 2003, 73.70% and 84.38%, respectively, of the total receivables from customers of the Parent Company were subject to periodic interest repricing. Remaining receivables carry annual fixed interest rates ranging from 4.75% to 8.42% in 2004 and from 4.75% to 7.37% in 2003 for foreign currency-denominated receivables, and from 5.00% to 13.00% in 2004 and from 5.00% to 16.00% in 2003 for peso-denominated receivables.

The breakdown of loans by contractual maturity follows:

	Group					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Loans and discounts	**₱34,897,835**	**₱30,310,753**	**₱65,208,588**	₱19,472,116	₱53,386,357	₱72,858,473
Customers' liabilities on acceptances, letters of credit and trust receipts	**1,188,633**	**2,036,793**	**3,225,426**	4,034,563	–	4,034,563
Bills purchased	**2,139,659**	**–**	**2,139,659**	989,065	–	989,065
Credit card accounts	**1,021,588**	**–**	**1,021,588**	936,428	–	936,428
Lease contracts receivable	**477,279**	**474,991**	**952,270**	368,425	424,622	793,047
Premiums receivable	**400,970**	**–**	**400,970**	294,141	–	294,141
Residual value of leased equipment	**25,095**	**113,157**	**138,252**	33,821	67,802	101,623
	₱40,151,059	**₱32,935,694**	**₱73,086,753**	₱26,128,559	₱53,878,781	₱80,007,340

	Parent Company					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Loans and discounts	**₱34,035,572**	**₱30,162,200**	**₱64,197,772**	₱19,268,281	₱52,671,863	₱71,940,144
Customers' liabilities on acceptances, letters of credit and trust receipts	**1,188,633**	**2,036,793**	**3,225,426**	4,034,563	–	4,034,563
Bills purchased	**2,139,659**	**–**	**2,139,659**	989,065	–	989,065
Credit card accounts	**1,021,588**	**–**	**1,021,588**	936,428	–	936,428
	₱38,385,452	**₱32,198,993**	**₱70,584,445**	₱25,228,337	₱52,671,863	₱77,900,200

Actual maturities may differ from contractual maturities because borrowers can prepay certain obligations, sometimes without penalties.

The information relating to loans as to secured and unsecured and as to collateral follows:

	Group			
	2004		2003	
	(In Thousand Pesos)			
	Amount	**%**	Amount	%
Secured:				
Real estate mortgage	**₱20,801,859**	**28.46**	₱28,210,649	35.26
Chattel mortgage	**3,863,525**	**5.29**	2,948,454	3.69
Shares of stock	**1,483,679**	**2.03**	1,689,049	2.11
Bank deposit hold-out	**1,339,987**	**1.83**	1,019,153	1.27
Others	**24,552,747**	**33.60**	26,887,054	33.61
	52,041,797	**71.21**	60,754,359	75.94
Unsecured	**21,044,956**	**28.79**	19,252,981	24.06
	₱73,086,753	**100.00**	₱80,007,340	100.00

	Parent Company			
	2004		2003	
	(In Thousand Pesos)			
	Amount	**%**	Amount	%
Secured:				
Real estate mortgage	**₱20,694,302**	**29.32**	₱28,060,994	36.02
Chattel mortgage	**3,725,273**	**5.28**	1,920,886	2.47
Bank deposit hold-out	**1,265,992**	**1.79**	1,017,574	1.31
Shares of stock	**1,231,266**	**1.74**	1,680,435	2.16
Others	**23,600,477**	**33.44**	26,871,875	34.49
	50,517,310	**71.57**	59,551,764	76.45
Unsecured	**20,067,135**	**28.43**	18,348,436	23.55
	₱70,584,445	**100.00**	₱77,900,200	100.00

The information on loan concentration as to industry follows:

	Group			
	2004		2003	
	(In Thousand Pesos)			
	Amount	**%**	Amount	%
Manufacturing (various)	**₱15,614,858**	**21.37**	₱17,615,673	22.02
Wholesale and retail trade	**12,210,086**	**16.71**	11,127,059	13.91
Real estate, renting and business activities	**11,586,121**	**15.85**	14,736,082	18.42
Other community, social and personal services	**10,232,527**	**14.00**	12,111,187	15.14
Electricity, gas and water	**8,267,178**	**11.31**	7,683,485	9.60
Transport, storage and communications	**4,663,815**	**6.38**	4,856,326	6.07
Public administration and defense	**2,579,331**	**3.53**	728,805	0.91
Agriculture, hunting and forestry	**2,486,479**	**3.40**	4,251,202	5.31
Construction	**2,036,870**	**2.79**	2,585,152	3.23
Private household	**878,864**	**1.20**	764,375	0.95
Financial intermediaries	**855,632**	**1.17**	2,575,181	3.22
Education	**803,065**	**1.10**	296,922	0.37
Mining and quarrying	**513,679**	**0.70**	465,041	0.58
Hotel and restaurant	**132,195**	**0.18**	173,921	0.22
Health and social work	**36,472**	**0.05**	21,763	0.03
Fishing	**27,611**	**0.04**	15,166	0.02
Others	**161,970**	**0.22**	–	–
	₱73,086,753	**100.00**	₱80,007,340	100.00

	Parent Company			
	2004		2003	
	(In Thousand Pesos)			
	Amount	**%**	Amount	%
Manufacturing (various)	**₱15,098,420**	**21.39**	₱17,615,673	22.61
Wholesale and retail trade	**11,820,686**	**16.75**	11,045,067	14.18
Real estate, renting and business activities	**11,165,571**	**15.82**	13,391,988	17.19
Other community, social and personal services	**10,066,268**	**14.26**	11,979,125	15.38
Electricity, gas and water	**8,267,178**	**11.71**	7,683,485	9.86
Transport, storage and communications	**4,351,476**	**6.16**	4,856,326	6.23
Public administration and defense	**2,579,331**	**3.65**	728,805	0.94
Agriculture, hunting and forestry	**2,486,479**	**3.52**	4,251,202	5.46
Construction	**2,034,931**	**2.88**	2,585,150	3.32
Financial intermediaries	**921,421**	**1.31**	2,543,697	3.26
Education	**776,401**	**1.10**	296,922	0.38
Mining and quarrying	**513,679**	**0.73**	465,041	0.60
Private household	**307,343**	**0.44**	246,869	0.32
Hotel and restaurant	**131,178**	**0.19**	173,921	0.22
Health and social work	**36,472**	**0.05**	21,763	0.03
Fishing	**27,611**	**0.04**	15,166	0.02
	₱70,584,445	**100.00**	₱77,900,200	100.00

The BSP considers that loan concentration exists when the total loan exposure to a particular industry exceeds 30.00% of the total loan portfolio. As of December 31, 2004 and 2003, the Group does not have loan concentration risk to any particular industry.

Nonaccruing loans follow:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Secured	**₱21,730,980**	₱32,692,559	**₱21,697,885**	₱32,533,009
Unsecured	**14,398,991**	9,626,460	**14,314,920**	9,625,620
	₱36,129,971	₱42,319,019	**₱36,012,805**	₱42,158,629

Current banking regulations allow banks that have no unbooked valuation reserves and capital adjustments to exclude from nonperforming classification those receivables classified as Loss in the latest examination of the BSP which are fully covered by allowance for probable losses, provided that interest on said receivables shall not be accrued. The details of the nonperforming loans (NPLs) of the Group and of the Parent Company follow:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Total NPLs	**₱37,738,193**	₱45,190,092	**₱37,621,027**	₱45,004,465
Less NPLs fully covered by allowance for probable losses	**9,532,547**	9,058,385	**9,436,975**	8,935,869
	₱28,205,646	₱36,131,707	**₱28,184,052**	₱36,068,596

Most of these receivables are secured, mainly by real estate or chattel mortgages.

Restructured receivables of the Group and of the Parent Company as of December 31, 2004 and 2003 amounted to ₱19.1 billion and ₱23.2 billion, respectively.

In October 2004, the Parent Company's share in the loans receivable from NSC with a book value of ₱5.3 billion was part of the assets sold to the SPV companies under the provisions of RA No. 9182 (Note 5). In consideration for such sale, the SPV companies issued zero-interest coupon notes (Note 5) and paid cash totalling ₱4.2 billion to the Parent Company. In accordance with the BSP Memorandum dated February 16, 2004, *Accounting Guidelines on the Sale on Nonperforming Assets (NPAs) to Special Purpose Vehicles,* the ₱1.6 billion allowance for probable losses previously provided for the NSC loans receivable was released by the Parent Company to cover additional allowance for probable losses required for other existing NPAs and other risk assets of the Parent Company.

With the release of such allowance, the loss on the sale of the NSC loans receivable to the SPV amounting to ₱1.1 billion representing the difference between the carrying value of the receivables and consideration received was deferred by the Parent Company as allowed under the regulations issued by the BSP for banks and financial institutions availing of the provisions of RA No. 9182. Under such regulations, losses are allowed to be amortized over 10 years based on the following schedule:

End of Period From Date of Transaction	Cumulative Write-down of Deferred Charges
Year 1	5%
Year 2	10%
Year 3	15%
Year 4	25%
Year 5	35%
Year 6	45%
Year 7	55%
Year 8	70%
Year 9	85%
Year 10	100%

For the purpose of computing the Parent Company's income tax, the loss is treated as an ordinary loss and will be carried over as a deduction from the Parent Company's taxable gross income for a period of five consecutive taxable years immediately following the year of sale.

Had the loss on the sale of NPA been charged against current operations, as required by accounting principles generally accepted in the Philippines, net income in 2004 and capital funds as of December 31, 2004 would have decreased by ₱1.1 billion.

7. **Bank Premises, Furniture and Equipment**

The composition of and changes in bank premises, furniture and equipment follow:

	Group			
	Furniture, Fixtures and Equipment	**Leasehold Improvements - Net**	**2004**	2003
	(In Thousand Pesos)			
At Cost				
At January 1	**₱3,639,711**	**₱118,381**	**₱3,758,092**	₱3,908,321
Additions	**371,437**	**45,772**	**417,209**	154,846
Disposals	**(259,006)**	**(948)**	**(259,954)**	(281,903)
At December 31	**3,752,142**	**163,205**	**3,915,347**	3,781,264
Accumulated Depreciation				
At January 1	**3,079,259**	**–**	**3,079,259**	3,037,310
Depreciation and amortization	**269,226**	**38,145**	**307,371**	302,594
Disposals	**(198,047)**	**–**	**(198,047)**	(237,473)
At December 31	**3,150,438**	**38,145**	**3,188,583**	3,102,431
Net Book Value at December 31	**₱601,704**	**₱125,060**	**₱726,764**	₱678,833

	Group			
	Land	**Buildings**	**2004**	2002
	(In Thousand Pesos)			
At Appraised Value				
At January 1	**₱10,192,449**	**₱5,736,945**	**₱15,929,394**	₱15,684,162
Additions	**3,968**	**15,877**	**19,845**	430,056
Disposals	**–**	**(50,312)**	**(50,312)**	(184,824)
Reclassifications	**(12,557)**	**–**	**(12,557)**	–
At December 31	**10,183,860**	**5,702,510**	**15,886,370**	15,929,394
Accumulated Depreciation and Impairment Loss				
At January 1	**3,409**	**1,056,604**	**1,060,013**	816,271
Depreciation	**–**	**148,815**	**148,815**	147,400
Impairment loss	**–**	**–**	**–**	97,987
Disposals	**–**	**(2,490)**	**(2,490)**	(1,645)
Reclassifications	**(321)**	**–**	**(321)**	–
At December 31	**3,088**	**1,202,929**	**1,206,017**	1,060,013
Net Book Value at December 31	**₱10,180,772**	**₱4,499,581**	**₱14,680,353**	₱14,869,381

	Parent company			
	Furniture, Fixtures and Equipment	Leasehold Improvements - Net	2004	2003
		(In Thousand Pesos)		
At Cost				
At January 1	**₱3,408,319**	**₱94,217**	**₱3,502,536**	₱3,628,240
Additions	**346,540**	**9,010**	**355,550**	138,205
Disposals	**(244,447)**	**–**	**(244,447)**	(240,767)
At December 31	**3,510,412**	**103,227**	**3,613,639**	3,525,678
Accumulated Depreciation				
At January 1	**2,894,849**	**–**	**2,894,849**	2,839,026
Depreciation and amortization	**247,632**	**20,432**	**268,064**	282,162
Disposals	**(182,858)**	**–**	**(182,858)**	(203,197)
At December 31	**2,959,623**	**20,432**	**2,980,055**	2,917,991
Net Book Value at December 31	**₱550,789**	**₱82,795**	**₱633,584**	₱607,687

	Parent Company			
	Land	Buildings	2004	2002
		(In Thousand Pesos)		
At Appraised Value				
At January 1	**₱10,192,449**	**₱5,676,923**	**₱15,869,372**	₱15,442,093
Additions	**3,968**	**15,877**	**19,845**	430,056
Disposals	**–**	**(3,462)**	**(3,462)**	(2,777)
Reclassifications	**(12,557)**	**–**	**(12,557)**	–
At December 31	**10,183,860**	**5,689,338**	**15,873,198**	15,869,372
Accumulated Depreciation and Impairment Loss				
At January 1	**3,409**	**1,053,048**	**1,056,457**	811,197
Depreciation	**–**	**147,373**	**147,373**	147,352
Impairment loss	**–**	**–**	**–**	97,987
Disposals	**–**	**(168)**	**(168)**	(79)
Reclassifications	**(321)**	**–**	**(321)**	–
At December 31	**3,088**	**1,200,253**	**1,203,341**	1,056,457
Net Book Value at December 31	**₱10,180,772**	**₱4,489,085**	**₱14,669,857**	₱14,812,915

In 2003, an impairment loss on the Parent Company's land and buildings amounting to ₱98.0 million was included in Miscellaneous Expense in the statements of income. The impaired land and buildings were written down to their recoverable value which is equivalent to their net selling price. The net selling price is the amount which maybe obtained from the sale of the assets in an arm's length transaction between knowledgeable willing parties, less the cost of disposal.

Depreciation on the appraisal increment of the buildings amounted to ₱60.3 million, ₱59.7 million and ₱40.3 million in 2004, 2003, and 2002, respectively, for the Parent Company.

Depreciation and amortization expense, inclusive of the depreciation on appraisal increment of the buildings, charged against operations of the Group amounted to ₱456.2 million, ₱450.0 million and ₱511.2 million in 2004, 2003 and 2002, respectively, and ₱415.4 million in 2004, ₱429.5 million in 2003 and ₱462.6 million in 2002 for the Parent Company. Had the land and buildings been carried at cost, the net book value of the land and buildings would have been ₱5.3 billion and ₱5.4 billion as of December 31, 2004 and 2003, respectively, for the Group, and ₱5.3 billion as of December 31, 2004 and 2003 for the Parent Company.

Land and buildings with carrying amount of ₱10.0 billion in 2004 and ₱11.1 billion in 2003 were pledged as collateral to secure the Parent Company's borrowings from PDIC (Note 13).

8. **Investments in Subsidiaries and Associates**

The details of this account follow:

	Equity Interest (Percentage)	Group 2004	Group 2003	Parent Company 2004	Parent Company 2003
		(In Thousand Pesos)			
At equity:					
Acquisition cost of:					
PNB International Investments Corporation	100	**₱–**	₱–	**₱1,250,161**	₱1,250,161
PNB Europe PLC	100	**–**	–	**508,095**	508,095
PNB Capital	100	**–**	–	**350,000**	500,000
PNB Forex, Inc.	100	**–**	–	**105,000**	200,000
PNB Holdings Corporation	100	**–**	–	**84,113**	84,113
PNB Securities, Inc.	100	**–**	–	**58,100**	58,100
PNB Italy - SpA	100	**–**	–	**57,858**	57,858
PNB International Finance Limited	100	**–**	–	**29,763**	29,763
PNB Corporation - Guam	100	**–**	–	**11,241**	11,241
PNB Remittance Center, Ltd.	100	**–**	–	**1,785**	1,785
Omicron Asset Portfolio (SPV-AMC), Inc.	100	**–**	–	**31,250**	–
Opal Portfolio Investments (SPV-AMC), Inc.	100	**–**	–	**31,250**	–
Tanzanite Investments (SPV-AMC), Inc.	100	**–**	–	**31,250**	–
Tau Portfolio Investments (SPV-AMC), Inc.	100	**–**	–	**31,250**	–
National Service Corporation (Naseco)	100	**–**	–	**–**	2,000
Japan - PNB Leasing	60	**–**	–	**91,850**	91,850
PNB Venture Capital Corporation	60	**3,600**	3,600	**3,600**	3,600
Beneficial - PNB Life Insurance Company, Inc.	40	**499,813**	499,813	**499,813**	499,813
		503,413	503,413	**3,176,379**	3,298,379
Accumulated equity in net earnings:					
Balance at beginning of year		**117,296**	67,154	**1,258,122**	1,607,176
Equity in net earnings (losses) for the year		**30,219**	59,754	**331,586**	(74,774)
Recalled dividends receivable		**–**	–	**57,866**	–
Dividends received during the year		**(7,210)**	(9,612)	**(25,627)**	(709,373)
Elimination of receivables from Naseco (Note 24)		**–**	–	**–**	435,093
Balance at end of year		**140,305**	117,296	**1,621,947**	1,258,122
Accumulated translation adjustment		**–**	–	**496,817**	433,702
Accumulated translation adjustment applied to deficit		**–**	–	**1,626,430**	1,626,430
Unrealized loss on ASS of subsidiaries		**–**	–	**(4,719)**	(4,633)
Revaluation increment on buildings of subsidiaries		**–**	–	**6,115**	9,412
		643,718	620,709	**6,922,969**	6,621,412
Noncurrent available-for-sale investment - at cost		**20,493**	20,493	**20,493**	20,493
At cost - net of allowance for probable losses of ₱332.1 million in 2004 and ₱352.1 million in 2003 (Note 11)		**118,493**	98,409	**115,909**	95,910
		₱782,704	₱739,611	**₱7,059,371**	₱6,737,815

Recalled dividends receivable represent dividends declared in 2001 and 2003 but recalled in 2004 by two wholly owned subsidiaries of the Parent Company.

Investment in PNB Venture Capital Corporation was deconsolidated in 2001 in accordance with management's plan to liquidate such investment. As of December 31, 2004, approval of the planned liquidation is pending with the SEC.

On March 31, 2003, Naseco's BOD approved the cessation of the Company's operations effective June 15, 2003. Accordingly, on April 22, 2003, Naseco's BOD approved the dissolution and amendment of the articles of incorporation of the Company by shortening the term of its existence from 50 years since incorporation date to January 15, 2004. On May 9, 2003, the Parent Company's BOD gave its consent to the dissolution of Naseco. The dissolution of the Company was approved by the SEC on December 29, 2004. No specific disclosure is made on any contingent liability that the Parent Company is exposed to because any such specific disclosure would prejudice the Group's position in respect to such contingent liability (Note 24).

Following the cessation of Naseco's operations, the excess of the Parent Company's share in the net losses of Naseco against the carrying amount of its investment as of December 31, 2003 amounting to ₱435.1 million was eliminated against the Parent Company's outstanding receivables from Naseco.

As discussed in Note 2, the SEC approved on November 7, 2002 the application of the accumulated translation adjustment of ₱1.6 billion to eliminate the Parent Company's remaining deficit of ₱1.3 billion as of December 31, 2001, after applying the total reduction in par value amounting to ₱7.6 billion. The SEC approval is subject to the following conditions: (a) the remaining translation adjustment of ₱310.7 million as of December 31, 2001 (shown as part of Capital Paid in Excess of Par Value) will not be used to wipe out losses that may be incurred in the future without prior approval of SEC; and (b) for purposes of dividend declaration, any future surplus account of the Parent Company shall be restricted to the extent of the deficit wiped out by translation adjustment.

The carrying values of the Parent Company's significant investments in subsidiaries and associate follow:

	2004			2003		
	Acquisition Cost	**Accumulated Equity and Other Adjustment**	**Carrying Value**	Acquisition Cost	Accumulated Equity and Other Adjustments	Carrying Value
			(In Thousand Pesos)			
PNB International Investments Corporation	**₱1,250,161**	**₱1,269,577**	**₱2,519,738**	₱1,250,161	₱1,115,249	₱2,365,410
PNB Europe PLC	**508,095**	**460,353**	**968,448**	508,095	457,405	965,500
PNB International Finance Limited	**29,763**	**859,820**	**889,583**	29,763	843,026	872,789
PNB Holdings Corporation	**84,113**	**724,164**	**808,277**	84,113	577,228	661,341
Beneficial - PNB Life Insurance Company, Inc.	**499,813**	**138,843**	**638,656**	499,813	115,834	615,647
PNB Capital	**350,000**	**81,960**	**431,960**	500,000	36,958	536,958
PNB Forex, Inc.	**105,000**	**34,989**	**139,989**	200,000	18,464	218,464
	₱2,826,945	**₱3,569,706**	**₱6,396,651**	₱3,071,945	₱3,164,164	₱6,236,109

9. Real and Other Properties Owned or Acquired

This account consists of:

	Group		**Parent Company**	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
ROPOA	**₱28,970,979**	₱28,898,269	**₱28,970,403**	₱28,897,694
Less allowance for probable losses (Note 11)	**4,143,964**	4,015,695	**4,143,964**	4,015,695
	₱24,827,015	₱24,882,574	**₱24,826,439**	₱24,881,999

Certain ROPOA consisting of prime commercial properties amounting to ₱1.9 billion and ₱2.4 billion as of December 31, 2004 and 2003, respectively, were pledged as collateral to secure the Parent Company's bills payable to PDIC inclusive of the bills payable transferred from BSP (Note 13).

10. Other Resources

This account consists of:

	Group		Parent Company	
	2004	2003 (As Restated - Note 3)	2004	2003 (As Restated - Note 3)
	(In Thousand Pesos)			
Accrued interest receivable (Note 2)	**₱6,881,625**	₱6,734,497	**₱6,843,589**	₱6,681,809
Deficiency claims receivable	**4,619,191**	4,457,274	**4,619,191**	4,457,274
Accounts receivable	**4,287,980**	4,628,607	**4,218,415**	4,509,214
Transferred assets	**2,937,519**	1,645,353	**2,937,519**	1,645,353
Deferred tax assets (Note 19)	**4,547,802**	4,555,878	**4,510,584**	4,510,584
Foreign currency notes and coins on hand, checks and other cash items	**1,762,348**	1,756,195	**1,620,844**	1,637,283
Sales contract receivable - net of unrealized gain on sale of ₱612.8 million in 2004 and ₱529.6 million in 2003	**1,568,359**	1,404,659	**1,568,359**	1,404,659
Deferred charges - net (Notes 5 and 6)	**1,214,125**	115,947	**1,207,338**	115,666
Net interoffice accounts	**367,589**	837,612	**367,589**	837,612
Special rehabilitation accounts	**241,290**	266,592	**241,290**	266,592
Deferred reinsurance premiums	**134,320**	85,722	**–**	–
Prepaid expenses	**94,569**	221,987	**80,696**	203,363
Miscellaneous	**1,612,472**	1,630,553	**1,290,973**	1,801,116
	30,269,189	28,340,876	**29,506,387**	28,070,525
Less allowance for probable losses (Note 11)	**11,865,537**	10,094,820	**11,822,360**	10,027,977
	₱18,403,652	₱18,246,056	**₱17,684,027**	₱18,042,548

Accounts receivable as of December 31, 2003 includes the receivable of ₱230.1 million from the NG representing the balance of certain claims from the NG, net of the settlement in the form of bonds (Note 5). Such claims have been fully provided with allowance for probable losses.

Accounts receivable also includes advances to a fund set aside by the Parent Company to regularize its employees' retirement fund. The Parent Company's Executive and Trust Committees, in a joint executive session on November 25, 2004, approved the consolidation of the Parent Company's Employees Welfare Fund (Welfare Fund) and PNB Retirement Fund, Inc. (PRFI) into its Employees Regular Retirement Fund (Retirement Fund). As of December 31, 2004, the total net asset value of the Welfare Fund, PRFI and the Retirement Fund amounted to ₱875.2 million, inclusive of the receivable of ₱257.5 million from certain creditors of three of the investee companies (Note 17).

Sales contract receivable bear fixed interest rate per annum of 10.30% to 21.00% in 2004 and 12.00% to 18.00% in 2003.

On November 27, 1997, Maybank Philippines, Inc. (Maybank) and the Parent Company signed a deed of assignment transferring to the Parent Company certain Maybank assets and liabilities amounting to ₱1.9 billion and ₱1.3 billion, respectively, in connection with the sale of the Parent Company's 60.00% equity in Maybank. As of December 31, 2004 and 2003, the balance of Transferred Assets amounting to ₱2.6 billion and ₱1.2 billion may be offset against the equivalent amount of transferred liabilities (included under Bills Payable to BSP and Local Banks - Note 13). The excess of the transferred assets over the transferred liabilities is fully covered by an allowance for probable losses. The remaining equity ownership of the Parent Company in Maybank was sold in June 2000 (Note 24).

Special rehabilitation accounts represent the portion of the assets previously transferred to the NG as part of the Parent Company's rehabilitation in 1986. These receivables were repurchased by the Parent Company from the NG at a discount and are mostly secured by real estate mortgages. These receivables are likewise fully covered by an allowance for probable losses.

Miscellaneous include checks and other cash items, other investments, investment in real estate, rental deposits and stationery and supplies.

The breakdown of financial resources included in Other Resources by contractual maturity follows:

	Group					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Accrued interest receivable	**₱6,881,625**	**₱–**	**₱6,881,625**	₱6,734,497	₱–	₱6,734,497
Deficiency claims receivable	**4,619,191**	**–**	**4,619,191**	4,457,274	–	4,457,274
Accounts receivable	**4,287,980**	**–**	**4,287,980**	4,628,607	–	4,628,607
Transferred assets	**2,937,519**	**–**	**2,937,519**	1,645,353	–	1,645,353
Sales contract receivable	**242,269**	**1,938,913**	**2,181,182**	114,170	1,820,098	1,934,268
Foreign currency notes and coins on hand, checks and other cash items	**1,762,348**	**–**	**1,762,348**	1,756,195	–	1,756,195
Special rehabilitation accounts	**241,290**	**–**	**241,290**	266,592	–	266,592
Deferred reinsurance premiums	**134,320**	**–**	**134,320**	85,722	–	85,722
	₱21,106,542	**₱1,938,913**	**₱23,045,455**	₱19,688,410	₱1,820,098	₱21,508,508

	Parent Company					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Accrued interest receivable	**₱6,843,589**	**₱–**	**₱6,843,589**	₱6,681,809	₱–	₱6,681,809
Deficiency claims receivable	**4,619,191**	**–**	**4,619,191**	4,457,274	–	4,457,274
Accounts receivable	**4,218,415**	**–**	**4,218,415**	4,509,214	–	4,509,214
Transferred assets	**2,937,519**	**–**	**2,937,519**	1,645,353	–	1,645,353
Sales contract receivable	**242,269**	**1,938,913**	**2,181,182**	114,170	1,820,098	1,934,268
Foreign currency notes and coins on hand, checks and other cash items	**1,620,844**	**–**	**1,620,844**	1,637,283	–	1,637,283
Special rehabilitation accounts	**241,290**	**–**	**241,290**	266,592	–	266,592
	₱20,723,117	**₱1,938,913**	**₱22,662,030**	₱19,311,695	₱1,820,098	₱21,131,793

11. Allowance for Probable Losses

Changes in the allowance for probable losses follow:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Balance at beginning of year				
IBODI	**₱201,745**	₱195,281	**₱201,745**	₱195,281
Receivables from customers	**18,127,028**	19,020,886	**17,926,497**	18,587,967
Investments in subsidiaries and associates	**352,091**	342,669	**352,086**	342,669
ROPOA	**4,015,695**	3,419,612	**4,015,695**	3,419,612
Other resources	**10,094,820**	11,009,850	**10,027,977**	10,965,888
	32,791,379	33,988,298	**32,524,000**	33,511,417
Provisions during the year	**840,913**	447,426	**808,973**	416,543
Accounts charged off	**(300,705)**	(1,090,869)	**(292,723)**	(824,797)
Reversals and others	**(753,183)**	(553,476)	**(748,274)**	(579,163)
Balance at end of year				
IBODI (Note 5)	**527,421**	201,745	**527,421**	201,745
Receivables from customers (Note 6)	**15,709,391**	18,127,028	**15,466,145**	17,926,497
Investments in subsidiaries and associates (Note 8)	**332,091**	352,091	**332,086**	352,086
ROPOA (Note 9)	**4,143,964**	4,015,695	**4,143,964**	4,015,695
Other resources (Note 10)	**11,865,537**	10,094,820	**11,822,360**	10,027,977
	₱32,578,404	₱32,791,379	**₱32,291,976**	₱32,524,000

12. **Deposit Liabilities**

The breakdown of deposit liabilities by contractual maturity follows:

	Group					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Demand	**₱14,476,485**	**₱–**	**₱14,476,485**	₱13,122,823	₱–	₱13,122,823
Savings	**72,082,712**	**47,958,768**	**120,041,480**	62,461,196	44,149,108	106,610,304
Time	**2,829,742**	**23,661,346**	**26,491,088**	–	26,182,061	26,182,061
	₱89,388,939	**₱71,620,114**	**₱161,009,053**	₱75,584,019	₱70,331,169	₱145,915,188

	Parent Company					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
	(In Thousand Pesos)					
Demand	**₱14,433,937**	**₱–**	**₱14,433,937**	₱13,223,617	₱–	₱13,223,617
Savings	**72,038,670**	**47,958,768**	**119,997,438**	62,422,757	44,149,108	106,571,865
Time	**4,887,122**	**23,661,346**	**28,548,468**	592,477	27,903,139	28,495,616
	₱91,359,729	**₱71,620,114**	**₱162,979,843**	₱76,238,851	₱72,052,247	₱148,291,098

Of the total deposit liabilities of the Parent Company, ₱6.1 billion in 2004 and ₱5.9 billion in 2003 were non-interest bearing. Remaining deposit liabilities generally earned annual fixed interest rates ranging from 0.50% to 4.13% in 2004 and from 0.50% to 3.00% in 2003 for foreign currency-denominated deposit liabilities, and from 1.00% to 14.55% in 2004 and from 1.00% to 13.94% in 2003 for peso-denominated deposit liabilities.

Under existing BSP regulations, non-FCDU deposit liabilities of the Parent Company are subject to liquidity reserves equivalent to 8.00% which increased to 10.00% starting February 5, 2004 and statutory reserves equivalent to 9.00%. Available reserves follow:

	2004	2003
Cash on hand	**₱3,285,009**	₱3,073,945
Due from BSP	**3,765,737**	1,115,502
ASS	**144,943**	149,540
IBODI	**22,207,192**	21,340,255
	₱29,402,881	₱25,679,242

As of December 31, 2004 and 2003, the Parent Company was in compliance with such regulations.

13. **Bills and Acceptances Payable**

This account consists of:

	Group		**Parent Company**	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Bills payable to:				
BSP and local banks (Note 10)	**₱2,884,474**	₱1,931,896	**₱2,704,474**	₱1,559,082
Foreign banks	**1,844,440**	1,616,641	**1,385,255**	1,369,641
PDIC and others (Notes 7 and 9)	**8,716,846**	8,904,960	**8,716,846**	8,904,960
	13,445,760	12,453,497	**12,806,575**	11,833,683
Acceptances outstanding	**88,898**	96,431	**88,898**	96,431
	₱13,534,658	₱12,549,928	**₱12,895,473**	₱11,930,114

The annual interest rates ranged from 1.00% to 3.44% in 2004 and from 1.21% to 2.31% in 2003 for foreign currency-denominated borrowings, and from 3.00% to 12.00% in 2004 and from 1.00% to 7.00% in 2003 for peso-denominated borrowings.

The breakdown of bills and acceptances payable by contractual maturity follows:

	Group					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
			(In Thousand Pesos)			
Bills payable	**₱3,971,513**	**₱9,474,247**	**₱13,445,760**	₱2,082,605	₱10,370,892	₱12,453,497
Acceptances outstanding	**88,898**	**–**	**88,898**	96,431	–	96,431
	₱4,060,411	**₱9,474,247**	**₱13,534,658**	₱2,179,036	₱10,370,892	₱12,549,928

	Parent Company					
	2004			2003		
	Due Within One Year	**Due Beyond One Year**	**Total**	Due Within One Year	Due Beyond One Year	Total
			(In Thousand Pesos)			
Bills payable	**₱3,673,116**	**₱9,133,459**	**₱12,806,575**	₱1,693,899	₱10,139,784	₱11,833,683
Acceptances outstanding	**88,898**	**–**	**88,898**	96,431	–	96,431
	₱3,762,014	**₱9,133,459**	**₱12,895,473**	₱1,790,330	₱10,139,784	₱11,930,114

The Parent Company's bills payable to BSP includes the transferred liabilities from Maybank amounting to ₱2.5 billion and ₱1.2 billion as of December 31, 2004 and 2003, respectively (Note 10).

Under the MOA mentioned in Note 2, the note payable to BSP of ₱13.9 billion was assigned to PDIC. Such assignment increased the Parent Company's total obligation to PDIC to ₱23.9 billion. Of this amount, (a) ₱10.0 billion was settled thru "dacion en pago" of the Parent Company's resources comprising of loans to, and debt securities issued by various government entities, (b) ₱7.8 billion was converted into convertible preferred shares of the Parent Company, and (c) the balance of ₱6.1 billion was converted into a note payable in ten years with interest of 91-day T-bill rate plus 1.00%.

Bills Payable - Others also includes fundings from the Development Bank of the Philippines, Land Bank of the Philippines and the Social Security System under which the Parent Company acts as a conduit for certain financing programs of these institutions. Lendings to such programs are shown under Receivables from Customers (Note 6).

14. **Subordinated Debt**

On December 19, 2003, the Parent Company's BOD approved the raising of lower tier 2 capital through the issuance in the local capital market of subordinated notes with maximum principal amount of ₱3.0 billion maturing in ten years but callable with step-up on August 16, 2009. The notes bear a coupon rate of 12.50% per annum with step-up after five years.

The issuance of the foregoing subordinated notes under the terms approved by the BOD was approved by the MB, in its Resolution No. 06/01-23-04 dated January 22, 2004, subject to the Parent Company's compliance with certain conditions.

Relative to this, on February 16, 2004, the Parent Company issued ₱3.0 billion, 12.50% Subordinated Notes (the Notes) due in 2014. Among the significant terms and conditions of the issuance of such Notes are:

(1) Issue price at 100.00% of the principal amount;
(2) The Notes bear interest at the rate of 12.50% per annum from and including February 16, 2004 to but excluding February 16, 2009. Interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2004 unless the Notes are previously redeemed, interest from and including February 16, 2009 to but excluding February 16, 2014 will be reset at 11.23%, the equivalent of the five-year MART1 FXTN as of February 9, 2004, plus a spread of 5.27% per annum. The stepped-up interest will be payable semi-annually in arrears on February 16 and August 16 of each year, commencing on August 16, 2009;
(3) The Notes constitute direct, unconditional unsecured and subordinated obligations of the Parent Company and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the Parent Company;
(4) The Parent Company may redeem the Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the tenth interest period from issue date, subject to the prior consent of the BSP. The Notes may not be redeemed at the option of the noteholders; and
(5) Each noteholder, by accepting a Note, irrevocably agrees and acknowledges that: (a) it may not exercise or claim any right of set-

off in respect of any amount owed by the Parent Company arising under or in connection with the Notes; and (b) it shall to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

15. **Other Financial Liabilities**

The following financial liabilities are due within one year from their respective statement of condition dates:

	Group		Parent Company	
	2004	2003 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)
	(In Thousand Pesos)			
Due to BSP	**₱103,326**	₱178,064	**₱103,326**	₱178,064
Margin deposits and cash letters of credit	**137,991**	202,189	**137,991**	202,189
Manager's checks and demand drafts outstanding	**477,893**	632,591	**477,893**	632,591
Accrued taxes, interest and other expenses	**6,043,362**	8,374,387	**5,980,389**	8,262,278
Other liabilities	**9,065,763**	6,324,000	**8,063,244**	5,479,731
	₱15,828,335	₱15,711,231	**₱14,762,843**	₱14,754,853

Accrued taxes, interest and other expenses consists of:

	Group		Parent Company	
	2004	2003 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)
	(In Thousand Pesos)			
Taxes (Note 19)	**₱191,157**	₱56,687	**₱187,991**	₱51,209
Interest	**4,238,288**	7,011,611	**4,235,961**	7,008,916
Others (Notes 17 and 18)	**1,613,917**	1,306,089	**1,556,437**	1,202,153
	₱6,043,362	₱8,374,387	**₱5,980,389**	₱8,262,278

Other liabilities consist of:

	Group		Parent Company	
	2004	2003 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)
	(In Thousand Pesos)			
Accounts payable	**₱3,554,073**	₱3,513,059	**₱3,176,634**	₱3,102,376
Deferred credits	**805,086**	645,499	**801,978**	638,469
Deferred tax liability (Note 19)	**626,170**	680,728	**606,246**	667,583
Reserve for unearned premiums	**241,602**	179,298	**–**	–
Deposits on lease contracts	**169,882**	130,604	**–**	–
Minority interest in Japan - PNB Leasing	**86,749**	80,130	**–**	–
Miscellaneous	**4,295,120**	1,855,540	**4,084,632**	1,738,886
	₱9,778,682	₱7,084,858	**₱8,669,490**	₱6,147,314

Miscellaneous include due to banks, bills purchased - contra, withholding tax payable and deferred commission income.

16. **Capital Funds**

Capital stock consists of:

	2004	2003	2002
		(In Thousand Pesos)*	
Preferred - ₱40 par value			
Authorized and issued - 195,175,444 shares	**₱7,807,018**	₱7,807,018	₱7,807,018
Common - ₱40 par value			
Authorized - 1,054,824,557 shares			
Issued - 378,070,472 shares	**15,122,819**	15,122,819	15,122,819
	₱22,929,837	₱22,929,837	₱22,929,837

* Except par value and number of shares

The movements in the number of shares and amounts of issued and fully paid capital stock follow (amounts in thousand pesos):

	Preferred Stock Issued					
	2004		2003		2002	
	No. of Shares	**Amount**	No. of Shares	Amount	No. of Shares	Amount
Balance at beginning of year	**195,175,444**	**₱7,807,018**	195,175,444	₱7,807,018	–	₱–
Issuance of stocks during the year	**–**	**–**	–	–	195,175,444	7,807,018
Balance at end of year	**195,175,444**	**₱7,807,018**	195,175,444	₱7,807,018	195,175,444	₱7,807,018

	Common Stock Issued					
	2004		2003		2002	
	No. of Shares	**Amount**	No. of Shares	Amount	No. of Shares	Amount
Balance at beginning of year	**378,070,472**	**₱15,122,819**	378,070,472	₱15,122,819	378,070,472	₱22,684,228
Reduction in par value during the year (applied to deficit)	**–**	**–**	–	–	–	(7,561,409)
Balance at end of year	**378,070,472**	**₱15,122,819**	378,070,472	₱15,122,819	378,070,472	₱15,122,819

The preferred shares have the following features:

(a) Non-voting, non-cumulative, fully participating on dividends with the common shares;

(b) Convertible, at any time at the option of the holder who is qualified to own and hold common shares;

(c) With mandatory and automatic conversion into common shares upon the sale of such preferred shares to any person other than the NG or any GOCC's; and

(d) With rights to subscribe to additional new preferred shares with all of the features described above.

In September 2000, the Parent Company offered for subscription through a pre-emptive rights offering, 171,850,215 common shares at an offer price of ₱60.00 per rights share with 171,850,215 warrants. The warrants were issued in the proportion of one warrant for every right to subscribe one share. One warrant entitles the holder to purchase one underlying share at an exercise price of ₱60.00 and is exercisable on or before November 16, 2005. Such rights and the underlying shares were issued out of the authorized capital stock of 833,333,334 shares and were offered to all stockholders of the Parent Company as of September 15, 2000, the record date.

As discussed in Note 2, on May 17, 2002 and June 25, 2002, the BOD and the stockholders, respectively, authorized the Parent Company to undergo another quasi-reorganization consisting of a reduction of the Parent Company's capital stock and applying the reduction of the capital stock to wipe out the deficit, and application of the translation adjustment to wipe out the deficit of the Parent Company as of December 31, 2001. On the same date, the BOD and the stockholders approved the increase of the Parent Company's authorized capital stock from ₱33.3 billion divided into 833,333,334 shares to ₱50.0 billion divided into 195,175,444 preferred shares at ₱40 par value and 1,054,824,557 common shares at ₱40 par value. With the reduction of the par value from ₱60 to ₱40, the exercise price of the warrants was also reduced from ₱60 to ₱40.

On July 23, 2002, the SEC simultaneously approved the Parent Company's application for the decrease in par value and the increase in authorized capital stock as well as the related amendments to the Parent Company's articles of incorporation.

On November 7, 2002, the SEC approved the quasi-reorganization of the Parent Company, subject to, among others, the conditions discussed in Note 2 Paragraph (1) iii.

The Parent Company's deficit before and after the quasi-reorganization in 2002 follows (in thousand pesos):

Deficit before the quasi-reorganization	
Balance at December 31, 2001	₱8,877,094
Reduction in par value during the year	(7,561,409)
Application of translation adjustment to deficit on quasi-reorganization	(1,626,430)
Deficit after the quasi-reorganization	310,745
Transfer to capital paid in excess of par value	(310,745)
Net loss for 2002 (Note 25)	1,948,596
Transfer to surplus reserves	25,626
Balance at December 31, 2002	₱1,974,222

Under existing BSP regulations, the determination of the Parent Company's compliance with regulatory requirements and ratios is based on the amount of the Parent Company's "unimpaired capital" (regulatory net worth) reported to the BSP, which is determined on the basis of regulatory accounting policies, which differ from Philippine GAAP in some aspects. In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted resources, should not be less than 10.00% for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiaries engaged in financial allied undertakings but excluding insurance companies). As discussed in Note 2, the BSP has approved the booking of additional appraisal increment of ₱431.0 million in 2001 on branch premises and recognition of the same in determining the capital adequacy ratio, and booking of translation adjustment of ₱1.6 billion in 2001 representing the increase in peso value of the investment in foreign subsidiaries for purposes of the quasi-reorganization and rehabilitation of the Parent Company provided that the same shall be excluded for dividend purposes.

A portion of the Parent Company's surplus corresponding to the undistributed equity in net earnings of investees amounting to ₱1.6 billion and ₱1.3 billion as of December 31, 2004 and 2003, respectively, is not available for dividend declaration until realized by the Parent Company through dividends from investees.

Specifically, under existing banking regulations, the combined capital accounts of each commercial bank should not be less than an amount equal to ten percent (10.00%) of its risk assets. Risk assets is defined as total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the MB of the BSP. As of December 31, 2004 and 2003, the Group is in compliance with such provision. The capital-to-risk assets ratio of the Group as reported to the BSP as of December 31, 2004 and 2003 is 15.90% and 13.70%, respectively.

As required by existing banking regulations, a portion of the Parent Company's surplus equivalent to 10.00% of the Parent Company's income from trust operations during the year is appropriated to surplus reserves until such surplus reserves is equivalent to 20.00% of the Parent Company's regulatory capital stock (Note 21).

17. **Retirement Plan**

The Parent Company's noncontributory retirement plan provides a retirement benefit equal to one hundred and twelve percent (112.00%) of plan salary per month for every year of credit service. Retirement expense charged against operations amounted to ₱206.1 million, ₱266.0 million and ₱189.9 million in 2004, 2003 and 2002, respectively, for the Group, and ₱203.9 million, ₱264.3 million and ₱182.8 million in 2004, 2003 and 2002, respectively, for the Parent Company.

To facilitate the adoption of PAS 19, the Group commissioned an independent actuary to do an actuarial valuation study of its retirement fund. Meanwhile, based on the latest September 30, 2003 actuarial valuation of the Parent Company's retirement plan, the actuarial accrued liability for retirement benefits amounted to ₱964.7 million. As of December 31, 2004, the Plan's net assets amounted to ₱875.2 million (Note 10). The principal actuarial assumptions used to determine retirement benefits include an investment yield of 11.00% per annum and salary increase rate of 6.00% per annum.

The Parent Company's BOD approved on October 24, 2002 the implementation of the Early Retirement Program (ERP) on February 3, 2003 to June 30, 2003. The total payments relating to ERP amounted to ₱36.1 million and ₱77.3 million in 2004 and 2003, respectively.

As of December 31, 2003, the latest actuarial valuation of the retirement plan of Japan - PNB Leasing, the actuarial present value of retirement benefits amounted to ₱0.7 million. The principal actuarial assumptions used to determine retirement benefits include an investment yield and salary increase rate of 10.00% per annum. No funding has been made to the accruals for retirement benefits to date. Accordingly, the accrued retirement liability including accrued interest expense as of December 31, 2004 and 2003 amounted to ₱0.7 million.

As of April 1, 2004, the latest actuarial valuation of the retirement plan of PNB General Insurers Co., Inc., a wholly owned subsidiary of PNB Holdings, the actuarial present value of retirement benefits amounted to ₱9.7 million. As of December 31, 2004 and 2003, the Plan's net assets approximate ₱9.8 million and ₱14.4 million, respectively. The principal actuarial assumptions used to determine retirement benefits include an investment yield and salary increase rate of 10.00% per annum.

Actuarial valuation is made at least every two years.

18. Leases

The Parent Company leases the premises occupied by some of its branches (about 41.59% of the branch sites are Parent Company-owned). Some of its subsidiaries also lease the premises occupied by their Head Offices and most of their branches. The lease contracts are for periods ranging from 1 to 25 years and are renewable at the Group's option under certain terms and conditions. Various lease contracts include escalation clauses, most of which bear an annual rent increase of 10.00%.

Rent expense charged against current operations (included in Occupancy and Other Equipment-related Expenses in the statements of income) amounted to ₱369.0 million in 2004, ₱337.1 million in 2003, and ₱296.8 million in 2002 for the Group, of which, ₱235.1 million in 2004, ₱205.5 million in 2003, and ₱187.6 million in 2002 pertain to the Parent Company.

Future minimum rentals payable under non-cancelable operating leases follow:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Within one year	**₱117,251**	₱154,183	**₱117,251**	₱154,183
Beyond one year but not more than five years	**251,350**	340,868	**251,350**	340,868
Beyond five years	**26,474**	47,962	**26,474**	47,962
	₱395,075	₱543,013	**₱395,075**	₱543,013

The Parent Company has entered into commercial property leases on its investment property portfolio consisting of the Parent Company's ROPOA. These non-cancelable leases have remaining non-cancelable lease terms of between two and five years. Some leases include a clause to enable upward revision of the rental charge on an annual basis based on prevailing market rates (such as 5.00% per year).

Future minimum rentals receivable under non-cancelable operating leases follow:

	Group		Parent Company	
	2004	2003	**2004**	2003
	(In Thousand Pesos)			
Within one year	**₱51,692**	₱39,590	**₱51,692**	₱39,590
Beyond one year but not more than five years	**97,036**	148,815	**97,036**	148,815
	₱148,728	₱188,405	**₱148,728**	₱188,405

19. **Income and Other Taxes**

Under Philippine tax laws, the Parent Company and certain subsidiaries are subject to percentage and other taxes (presented as Taxes and Licenses in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax (GRT) which was in effect until 2002, and documentary stamp tax. Effective January 1, 2003, the Parent Company and all subsidiaries in the financial intermediation business were subject to the value-added tax (VAT) instead of GRT. However, RA No. 9238 reimposes GRT on banks and financial intermediaries effective January 1, 2004.

Income taxes include the corporate income tax, discussed below, and final tax paid at the rate of 20.00%, which represents final withholding tax on gross interest income from government securities and other deposit substitutes. These income taxes, as well as the deferred tax benefits and provisions, are presented as Provision for Income Tax in the statements of income.

Under current tax regulations, the corporate income tax rate is 32.00%. Interest allowed as a deductible expense is reduced by an amount equivalent to 38.00% of interest income subjected to final tax. An MCIT of 2.00% on modified gross income is computed and compared with the regular income tax. Any excess of MCIT over the regular income tax is deferred and can be used as a tax credit against future income tax liability for the next three years. In addition, NOLCO is allowed as a deduction from taxable income in the next three years from the period of incurrence for the Parent Company and certain subsidiaries.

FCDU offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is generally subject to 10.00% income tax. In addition, interest income on deposit placement with other FCDUs and offshore banking units (OBUs) is taxed at 7.50%. RA No. 9294, which become effective in May 2004, provides that the income derived by the FCDU from foreign currency transactions with non-residents, OBUs, local commercial banks including branches of foreign banks is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% income tax.

Provision for income tax consists of:

	Group			Parent Company		
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
			(In Thousand Pesos)			
Current	**₱614,783**	₱586,338	₱532,119	**₱478,793**	₱429,706	₱410,863
Deferred	**3,359**	2,178	(260)	**–**	–	–
	₱618,142	₱588,516	₱531,859	**₱478,793**	₱429,706	₱410,863

The components of net deferred tax assets included in Other Resources follow:

	Group		Parent Company	
	2004	2003 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)
		(In Thousand Pesos)		
Deferred tax asset on:				
Allowance for probable losses	**₱4,530,782**	₱4,535,258	**₱4,510,584**	₱4,510,584
NOLCO and others	**17,020**	20,620	**–**	–
	₱4,547,802	₱4,555,878	**₱4,510,584**	₱4,510,584

Based on the five-year financial forecast prepared by management and duly approved by the Executive Committee of the BOD, the Parent Company's deferred tax assets of ₱4.5 billion as of December 31, 2004 shall be realized from its taxable profits within the next three to five years. Such financial forecast assumes average growth rates in its current business ranging from 11.00% to 23.00%, sale of ROPOA and certain bank premises, change in investment mix and financial products and services to be offered to existing and newly targeted clients.

The Parent Company and certain subsidiaries did not recognize deferred tax assets on the following differences:

	Group		Parent Company	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
Allowance for probable losses	**₱20,337,653**	₱20,534,935	**₱20,313,624**	₱20,470,932
NOLCO	**8,321,059**	13,263,793	**8,264,445**	13,170,046
MCIT	**17,903**	2,785	**15,949**	176
Others	**626,154**	549,753	**609,733**	529,082
	₱29,302,769	₱34,351,266	**₱29,203,751**	₱34,170,236

The components of deferred tax liability included in Miscellaneous Liabilities relating to items credited to capital funds follow:

	2004	2003
Deferred tax liability on:		
Revaluation increment on land and buildings	**₱606,246**	₱607,835
Unrealized gain on ASS	**–**	59,748
	₱606,246	₱667,583

Details of the Group's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
1992 to 1999	₱12,121	₱–	₱12,121	2012 to 2019
2000	3,343,375	3,343,375	–	2003
2001	6,656,980	6,656,980	–	2004
2002	4,400,046	–	4,400,046	2005
2003	2,228,206	1,555	2,226,651	2006
2004	1,694,362	–	1,694,362	2007
	₱18,335,090	₱10,001,910	₱8,333,180	

Details of the Group's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2001	₱614	₱614	₱–	2004
2002	1,275	753	522	2005
2003	953	–	953	2006
2004	16,428	–	16,428	2007
	₱19,270	₱1,367	₱17,903	

NOLCO includes net operating losses of PNB Corporation - Guam from 1992 to 1999 amounting to ₱12.1 million recognized based on applicable tax laws similar to those of USA. Guam's NOLCO matures 10 years from the date such NOLCO was incurred.

Details of the Parent Company's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2001	₱6,594,631	₱6,594,631	₱–	2004
2002	4,394,436	–	4,394,436	2005
2003	2,180,979	–	2,180,979	2006
2004	1,689,030	–	1,689,030	2007
	₱14,859,076	₱6,594,631	₱8,264,445	

Details of the Parent Company's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousand Pesos)		
2003	₱176	₱–	₱176	2006
2004	15,773	–	15,773	2007
	₱15,949	₱–	₱15,949	

As of December 31, 2004 and 2003, deferred income tax liabilities are not recognized on the undistributed earnings of certain subsidiaries and associates since such amounts are either not taxable, if declared dividends, or for use for expansion of foreign operations. Such undistributed earnings amounted to ₱1.6 billion and ₱1.3 billion in 2004 and 2003, respectively.

The reconciliation between the statutory income tax rate to effective income tax rate follows:

	Group			Parent Company		
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
			(In Thousand Pesos)			
Statutory income tax rate	**32.00%**	32.00%	32.00%	**32.00%**	32.00%	32.00%
Tax effects of:						
Unrecognized deferred taxes	**296.59**	1,715.65	(359.46)	**341.94**	2,269.00	(346.33)
Expired NOLCO	**218.34**	165.97	–	**253.65**	220.66	–
Tax-paid income	**(30.83)**	(41.04)	8.80	**(33.92)**	(49.76)	7.99
Non-deductible interest expense	**25.53**	32.87	(6.14)	**29.77**	43.18	(5.90)
FCDU income	**(14.16)**	(29.67)	8.06	**(16.53)**	(39.45)	7.76
Equity in net earnings of subsidiaries and associates	**10.92**	3.73	0.24	**12.75**	4.97	3.21
Tax-exempt income	**(8.63)**	(9.78)	0.99	**(10.08)**	(13.00)	0.96
Others - net	**(466.12)**	(1,777.88)	298.84	**(552.03)**	(2,378.43)	287.90
Effective income tax rate	**63.64%**	91.85%	(16.67%)	**57.55%**	89.17%	(12.41%)

Revenue Regulations (RR) No. 10-2002 defines expenses to be classified as entertainment, amusement and recreation (EAR) expenses and set a limit for the amount that is deductible for tax purposes. EAR expenses are limited to 1.00% of net revenues for sellers of services. EAR expenses charged against current operations (included in Miscellaneous Expense) amounted to ₱98.2 million in 2004 and ₱88.0 million in 2003 (Note 20).

20. Miscellaneous Income and Expenses

Miscellaneous income consists of:

	Group			Parent Company		
	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)	**2004**	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
			(In Thousand Pesos)			
Gain on sale or exchange of assets	**₱253,034**	₱376,456	₱444,571	**₱249,551**	₱372,806	₱408,817
Income from derivatives	**230,073**	107,843	144,692	**230,073**	107,843	144,692
Rental	**188,504**	172,299	192,452	**187,373**	171,234	191,387
Trust income	**168,371**	393,778	333,855	**168,371**	393,778	333,855
Miscellaneous	**647,584**	1,109,105	716,779	**511,384**	892,286	543,430
	₱1,487,566	₱2,159,481	₱1,832,349	**₱1,346,752**	₱1,937,947	₱1,622,181

Miscellaneous expenses consist of:

	Group			Parent Company		
	2004	2003	2002	**2004**	2003	2002
			(In Thousand Pesos)			
Insurance	**₱399,188**	₱309,011	₱333,320	**₱396,258**	₱307,621	₱332,261
Foreclosure	**223,165**	231,317	514,173	**223,165**	231,317	514,173
Management and professional fees	**143,199**	191,995	114,418	**129,480**	88,691	39,468
Transportation and travel	**123,080**	96,386	91,237	**120,642**	94,254	89,495
Stationery and supplies used	**107,704**	92,110	88,341	**105,768**	90,447	86,794
Representation and entertainment (Note 19)	**102,395**	91,817	80,271	**98,215**	87,971	76,961
Banking fees	**95,596**	88,544	93,415	**93,045**	87,060	92,114
Promotional expense	**85,028**	140,747	77,649	**85,027**	140,747	77,649
Miscellaneous	**960,109**	1,021,238	1,058,167	**401,209**	498,278	639,562
	₱2,239,464	₱2,263,165	₱2,450,991	**₱1,652,809**	₱1,626,386	₱1,948,477

Miscellaneous include information technology-related expenses, postage, telephone and telegraph, repairs and maintenances, and litigation expense.

21. **Trust Operations**

Securities and other properties held by the Parent Company in fiduciary or agency capacities for its customers are not included in the accompanying statements of condition since these are not resources of the Parent Company. Such resources held in trust were carried at a value of ₱14.6 billion and ₱46.7 billion as of December 31, 2004 and 2003, respectively (Note 24). In connection with the trust functions of the Parent Company, government securities amounting to ₱307.3 million and ₱474.6 million as of December 31, 2004 and 2003, respectively, are deposited with the BSP in compliance with the trust regulations.

In compliance with existing banking regulations, the Parent Company transferred from surplus to surplus reserves ₱36.5 million and ₱28.5 million in 2004 and 2003, respectively, corresponding to the 10.00% of the net income realized from its trust, investment management and other fiduciary business until such related surplus constitutes 20.00% of its regulatory capital stock (Note 16).

22. **Segment Information**

Business Segments

The Group's operating businesses are recognized and managed separately according to the nature of services provided and the different markets served with segment representing a strategic business unit. The Group's business segments follow:

Retail Banking - principally handling individual customers' deposits, and providing consumer type loans, credit card facilities and funds transfer facilities;

Corporate Banking - principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers;

Treasury - principally providing money market, trading and treasury services, as well as the management of the Group's funding operations by use of T-bills, government securities and placements and acceptances with other banks, through treasury and wholesale banking.

These segments are the bases on which the Group reports its primary segment information. Other operations of the Group comprise of the operations and financial control groups. Transactions between segments are conducted at estimated market rates on an arm's length basis. Interest is credited to or charged against business segments based on a pool rate which approximates the marginal cost of funds.

Geographical Segments

Although the Group's businesses are managed on a worldwide basis, the Group operates in five principal geographical areas of the world.

Business segment information of the Group follows:

	2004				
	Retail Banking	**Corporate Banking**	**Treasury**	**Other**	**Total**
Gross income	**₱2,669,829**	**₱4,961,837**	**₱6,455,916**	**₱1,427,408**	**₱15,514,990**
Segment result	**1,299,763**	**348,004**	**1,349,744**	**313,827**	**3,311,338**
Unallocated expenses					**2,333,397**
Income from operations before taxations and minority interest					**977,941**
Provision for income tax					**(618,142)**
Minority interest					**(6,620)**
Net income for the year					**₱353,179**
Other Information					
Segment resources	**35,152,132**	**73,437,747**	**95,056,321**	**5,417,254**	**₱209,063,454**
Unallocated resources					**7,378,102**
Total resources					**₱216,441,556**
Segment liabilities	**32,109,282**	**67,080,807**	**86,828,027**	**4,948,323**	**₱190,966,439**
Unallocated liabilities					**3,118,526**
Total liabilities					**₱194,084,965**
Other Segment Information					
Capital expenditures	**₱177,622**	**₱1,624**	**₱13,401**	**₱143,415**	**₱336,062**
Depreciation and amortization (Note 7)	**₱177,747**	**₱13,563**	**₱32,932**	**₱244,847**	**₱469,089**

2003 (As Restated - Note 3)

	Retail Banking	Corporate Banking	Treasury	Other	Total
Gross income	₱3,579,491	₱4,348,561	₱5,078,776	₱1,232,033	₱14,238,861
Segment result	863,870	289,074	549,449	403,390	2,105,783
Unallocated expenses					1,458,777
Income from operations before taxations and minority interest					647,006
Provision for income tax					(588,516)
Minority interest					(6,290)
Net income for the year					₱52,200
Other Information					
Segment resources	21,723,797	72,968,801	81,389,510	2,034,502	₱178,116,610
Unallocated resources					19,034,782
Total resources					₱197,151,392
Segment liabilities	21,156,669	70,813,679	79,008,730	1,974,989	₱172,954,067
Unallocated liabilities					1,983,138
Total liabilities					₱174,937,205
Other Segment Information					
Capital expenditures	₱75,282	₱6,158	₱19,344	₱125,509	₱226,293
Depreciation and amortization (Note 7)	₱169,479	₱4,382	₱6,180	₱277,298	₱457,339

In the Philippines, the Parent Company's home country, the Group offers a wide range of financial services as discussed in Note 1. Additionally, most of the remittance services are managed and conducted in Asia, Canada, USA and United Kingdom.

The distribution of the Group's gross income by geographical market follows:

	2004	2003 (As Restated - Note 3)
Philippines	**₱12,883,772**	₱11,757,713
Canada and the USA	**1,251,076**	1,175,307
Asia (excluding Philippines)	**1,088,389**	993,624
United Kingdom	**235,056**	269,862
Other European Union Countries	**56,697**	42,355
	₱15,514,990	₱14,238,861

23. Related Party Transactions

In the ordinary course of business, the Parent Company has loans and other transactions with its subsidiaries and affiliates, and with certain directors, officers, stockholders and related interest (DOSRI). Under the Parent Company's policy, these loans and other transactions are made substantially on the same terms as with other individuals and businesses of comparable risks. The amount of direct credit accommodations to each of the Parent Company's DOSRI, 70.00% of which must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Parent Company. In the aggregate, DOSRI loans generally should not exceed the Parent Company's capital funds or 15.00% of the Parent Company's total loan portfolio, whichever is lower. As of December 31, 2004 and 2003, the Parent Company is in compliance with such regulations.

The information relating to the DOSRI loans of the Parent Company and its subsidiaries follows (amounts in thousand pesos):

	2004	2003
Total outstanding DOSRI loans		
Inclusive of loans extended to NG, LGU's and GOCC's	**₱10,472,610**	₱14,195,502
Exclusive of loans extended to NG, LGU's and GOCC's	**1,909,666**	1,945,591
Percent of DOSRI loans to total loans		
Inclusive of loans extended to NG, LGU's and GOCC's	**14.33%**	17.74%
Exclusive of loans extended to NG, LGU's and GOCC's	**2.61**	2.43
Percent of unsecured DOSRI loans to total DOSRI loans		
Inclusive of loans extended to NG, LGU's and GOCC's	**1.38%**	0.78%
Exclusive of loans extended to NG, LGU's and GOCC's	**7.59**	5.66
Percent of past due DOSRI loans to total DOSRI loans	**0.02**	–
Percent of nonperforming DOSRI loans to total DOSRI loans	**–**	–

In accordance with existing BSP regulations, the reported DOSRI performing loans exclude loans extended to certain borrowers before these borrowers became DOSRI.

The information relating to Parent Company's receivables and other accommodations to the following government units follows:

	2004	2003
	(In Thousand Pesos)	
NG	**₱476,915**	₱503,329
LGU's	**2,905,168**	2,538,139
GOCC's	**9,180,861**	9,208,443
	₱12,562,944	₱12,249,911

For purposes of computing the maximum allowable DOSRI loans, which should not exceed the lower of the Parent Company's capital funds or 15.00% of the Parent Company's total loan portfolio, the aforementioned receivables from government units are not included in the computation of DOSRI limit.

The Parent Company has lease agreements with some of its subsidiaries. In 2004, the lease agreement was amended to indicate the share of the subsidiaries in the maintenance of the building in lieu of rental payments. The income related to these agreements amounting to ₱2.4 million in 2004 and ₱7.6 million in 2003 is included in Miscellaneous Income in the statements of income.

The significant account balances with respect to related parties included in the financial statements (after appropriate eliminations have been made) follow:

	2004		2003	
Related Party	**Loans Receivable**	**Interest Income**	Loans Receivable	Interest Income
		(In Thousand Pesos)		
Fortune Tobacco Corporation	**₱1,000,000**	**₱109,434**	₱1,000,000	₱91,512
Asia Brewery Inc.	**500,000**	**54,330**	523,389	49,435
Philippine Air Lines	**261,412**	**13,869**	955,467	113,308
Asian Institute of Management	**166,323**	**24,284**	–	–
Air Philippines Corporation	**–**	**–**	60,000	6,593
Others	**293,595**	**71,283**	287,209	73,178
	₱2,221,330	**₱273,200**	₱2,826,065	₱334,026

24. Commitments and Contingent Liabilities

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities that are not presented in the financial statements. These commitments and contingent liabilities include various guarantees, forward exchange contracts, commitments to extend credit, standby letters of credit, pending litigations including litigations involving redemption of foreclosed properties already sold to third parties and contested tax assessments. Several suits and claims remain unsettled. However, no specific disclosures on such unsettled assets and claims were made because any such specific disclosures would prejudice the Group's position with the other parties with whom it is in dispute. Such exemption from disclosures is allowed under IAS 37, *Provisions, Contingencies and Post Balance Sheet Events.* The Group and its legal counsel believe that any losses arising from these contingencies which are not specifically provided for will not have a material adverse effect on the financial statements.

In November 1994, the BSP, Maybank and the Parent Company executed a MOA providing for the settlement of Maybank's ₱3.0 billion liabilities to the BSP. Under this MOA, the Parent Company is jointly and severally liable with Maybank for the full compliance and satisfaction of the terms and conditions therein. The MOA provides for the creation of an escrow fund to be administered by the BSP where all collections from conveyed assets and certain annual guaranteed payments required under the MOA are to be deposited.

Relative to the sale of the Parent Company's 60.00 % interest in Maybank, the Parent Company has requested the BSP to consider the revision of the terms of the MOA to, among others, (a) delete the provision on the annual guaranteed payments in consideration of an immediate payment by the Parent Company of an agreed amount, and (b) exclude Maybank as a party to the MOA. On May 7, 1997, the BSP approved the Parent Company's request to amend the terms of the MOA, subject to the following conditions, among others:

a) The Parent Company shall remit ₱150.0 million to the escrow account out of the proceeds from sale;

b) The Parent Company shall remit to the escrow account an amount equivalent to 50.00% of any profit that may be realized by the Parent Company on account of the sale; and

c) If the amount in the escrow account has not reached the total of ₱3.0 billion by June 30, 2013, the difference shall be paid by the Parent

Company by way of a debit to its regular account with the BSP.

On November 28, 1997, the Parent Company remitted ₱150.0 million in compliance with item (a). The Parent Company anticipates that the payment of ₱150.0 million to the BSP together with the existing balance of the funds in escrow as of that date will allow the escrow account to reach the required ₱3.0 billion earlier than programmed. This has effectively released the Parent Company from any further payments under the MOA. As of December 31, 2004 and 2003, the total trust assets of the escrow account maintained with the BSP amounted to ₱1.6 billion and ₱1.3 billion, respectively. Average yield during the year ranged from 11.00% to 16.00%. Management expects that the value of the escrow account by 2013 will be more than adequate to cover the ₱3.0 billion liability due the BSP.

The Parent Company's remaining investment in Maybank was sold on June 29, 2000. The sale was approved by the BSP on August 16, 2000.

The following is a summary of various commitments and contingent liabilities at their equivalent peso contractual amounts:

	Group		Parent Company	
	2004	2003	**2004**	2003
		(In Thousand Pesos)		
Trust department accounts (Notes 5 and 21)	**₱14,561,817**	₱46,714,433	**₱14,561,817**	₱46,714,433
Unused commercial letters of credit	**12,422,322**	10,601,584	**12,422,322**	10,601,584
Inward bills for collection	**10,535,492**	9,926,938	**10,535,492**	9,926,938
Forward exchange bought	**7,783,125**	1,456,837	**7,783,125**	1,456,837
Forward exchange sold	**7,634,299**	3,315,446	**7,634,299**	3,315,446
Confirmed export letters of credit	**3,673,416**	3,927,542	**3,673,416**	3,927,542
Spot exchange bought	**1,888,261**	378,686	**1,888,261**	378,686
Spot exchange sold	**1,886,416**	820,199	**1,886,416**	820,199
Outward bills for collection	**133,462**	817,738	**132,405**	817,738
Others	**10,013,823**	5,095,543	**9,808,167**	5,095,543

Of the ₱46.7 billion of funds managed by the TBG as of December 31, 2003, approximately ₱39.5 billion (the Escrow Funds) was held by the Bank in escrow on behalf of the NG and other claimants in respect of the Escrow Funds. The ownership of the Escrow Funds has been subject of dispute and litigation for a number of years. On July 15, 2003, the Supreme Court decided that the Escrow Funds belong, and should be transferred, to the NG. In January 2004, the Escrow Funds were transferred to the NG. As a result of the transfer, aggregate amount of assets managed by the TBG declined by the full extent of the Escrow Funds.

25. Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing the net income (loss) for the year attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted income (loss) per share is calculated by dividing the net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the year adjusted for the effects of dilutive convertible preferred shares.

	2004	2003 (As Restated - Note 3)	2002 (As Restated - Note 3)
a) Net income (loss) before quasi-reorganization (in thousand pesos)			
a.1 Common shares	**₱232,931**	₱34,427	(₱3,297,335)
Preferred shares	**120,248**	17,773	(425,555)
a.2 Total	**353,179**	52,200	(3,722,890)
b) Weighted average number of common shares for basic income (loss) per share	**378,070,472**	378,070,472	378,070,472
c) Weighted average number of common shares for diluted income (loss) per share			
Effect of dilution:			
Convertible preferred shares	**195,175,444**	195,175,444	48,793,861
Adjusted weighted average number of common shares for diluted income (loss) per share	**573,245,916**	573,245,916	426,864,333
d) Basic income (loss) per share (a.1/b)	**₱0.62**	₱0.09	(₱8.72)
e) Diluted income (loss) per share (a.2/c)	**0.62**	0.09	(8.72)

The reconciliation of net income (loss), as previously reported to net income (loss), as restated follows:

	2003	2002
Net income (loss), as previously reported (Note 16)	₱168,578	(₱1,948,596)
Effects of change in accounting for:		
Leases (Note 3)	20,083	8,249
Deferred taxes (Note 3)	(136,461)	(1,782,543)
Net income (loss), as restated	₱52,200	(₱3,722,890)

26. **Financial Performance**

The following basic ratios measure the financial performance of the Parent Company:

	2004	2003 (As Restated - Note 3)
Return on average equity	**1.58%**	0.24%
Return on average assets	**0.17**	0.03
Net interest margin on average earning assets	**2.74**	1.50

27. **Notes to Cash Flow Statements**

The principal non-cash transactions pertain to the elimination of receivables from Naseco (Note 8) in 2003, and the conversion of debt from PDIC into equity shares of the Parent Company (Note 2) and the "dacion en pago" arrangement with PDIC (Note 2) in 2002.

Of the total interbank loans receivable of the Group and of the Parent Company as of December 31, 2004, ₱16.6 billion and ₱16.5 billion, respectively, shall mature within three months.

28. **Subsequent Events**

In March 2005, the Parent Company successfully bidded out its NPLs to a third company qualified bidder. The loss from such transaction is fully provided for as of December 31, 2004.

Risk Management

PNB, being in the business of taking risk, recognizes the institution's vulnerability to various forms of risk. The key risks that the Bank is facing in the order of priority are: credit risk, market risk and operational risk. At PNB, the approval of the risk management process, framework, policies, risk appetite and infrastructure is vested on the Risk Management Committee (RMC), a board level committee in charge of the oversight functions of the Bank's risk management. The Risk Management Group (RMG) under the Corporate Risk Manager supports the RMC in performing its task. RMG reviews risk exposures versus approved limits, drafts risk policies and assists line management in the formulation of risk reduction strategies.

CREDIT RISK

The management of credit risk at PNB involves a continuing independent review of credit limits, policies, systems and procedures; the approval of specific workout situations and pro-active portfolio management. The Bank has adopted a revised Internal Credit Rating System for corporate accounts which has more granular ratings (i.e. from five to ten ratings). This system dimensions the condition of prospective and existing individual credit exposures, the quality of the loan portfolio, and serves as basis to determine sufficiency of valuation reserves.

Limits have been established to monitor large exposures and concentration risks. The Bank observes a sound credit approval process by defining different levels of authority, ranging from the Business Center Credit Committee to the Senior Management Credit Committee, the Executive Committee and finally, the Board of Directors.

LIQUIDITY AND MARKET RISK

The Bank's Liquidity Management involves maintaining a sufficient and diverse funding capacity to accommodate fluctuations in asset and liability levels due to changes in the Bank's business operations or unanticipated events created by customer behavior or capital market conditions. Liquidity is dimensioned on a daily basis and under stressed situations.

Liquidity Risk is monitored and controlled primarily by a gap analysis of maturities of relevant assets and liabilities, as well as an analysis of liquid assets. Further, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities.

The Bank is exposed to the potential loss in market value of its portfolio arising from changes in market factors, principally interest rates and foreign exchange rates.

Market Risk is managed using a framework of market risk management policies and risk control procedures and limits. These limits are reviewed annually by RMG and approved by the Bank's Assets & Liabilities Committee (ALCO), the RMC and the Board of Directors. The monitoring of market risk trading limits and the reporting of any limit excess and rectification are carried out independently by RMG.

Market risk is dimensioned and controlled in both the trading book and in the balance sheet. In the trading book, market risk is controlled by a daily analysis of the Value-At-Risk (VAR) of trading instruments under normal market conditions. In the balance sheet, interest rate risk is dimensioned using Earnings-At-Risk (EAR) which arrays the repricing behaviors of assets and liabilities. The volatilities used for this regular analysis are those for a rolling one year period, updated quarterly. The risk amounts computed are for a 99% confidence level.

The Bank also uses backtesting to verify the results of the daily VAR calculation. Likewise, the Bank performs stress tests wherein the trading portfolios are valued under extreme market scenarios not covered by the confidence interval of the Bank's VAR model.

OPERATIONAL RISK

At PNB, the primary responsibility for managing operational risk rests with line management. The Bank dimensions operational risk using key risk indicators, self assessments, and reports on loss events. Each operating unit develops a business continuity plan subject to an annual review process to ensure minimum disruption in cases of emergency. (The product manual process) is also in place covering all bank products for the different product clusters.

Corporate Governance

PNB adheres to the principles of good governance as culled from leading best practices internationally and on a national level. It subscribes to the philosophy of integrity, accountability and transparency in its manner of doing business, fair dealing with its clients, investors, staff, stockholders and its various publics, professionalism in managing the company and its subsidiaries and respect for the laws and regulations of the countries affecting its business. Internally, if follows a philosophy of rational checks and balances as well as a structured approach to its operating processes.

To this end, the bank has promulgated a Revised Manual on Corporate Governance and appointed a senior officer to ensure compliance with the provisions of the Manual. The Directors, Advisors and Executive Officers of the Bank have taken a course on Corporate Governance to be able to understand and implement the principles thereof in a consistent and satisfactory manner.

Under the Manual, compliance with the principles of good corporate governance principally starts with the Board of Directors. It is the Board's responsibility to foster the long-term success of the corporation and secure its sustained competitiveness in accordance with its fiduciary responsibility. In order to have a central focus for the bank's activities, the Board has appropriately established the company's Mission and Vision Statements.

To have a structure for compliance, the Manual established and defined the responsibilities and functions of the Board and the various Committees necessary for good governance, i.e., the Corporate Governance Committee, the Audit and Compliance Committee, the Risk Management Committee and the roles of the External and Internal Auditors and the Corporate Secretary. The Manual also established an evaluation system by which the Directors and the Executive Officers can rate the bank periodically against certain leading practices and principles on good corporate governance. Last but not least, the Manual made provisions for the protection of Investors' Rights including Minority Interests.

The evaluation system which was provided to measure or determine the extent of compliance with the Manual of Corporate Governance consists of a Self-Assessment Questionnaire which is filled up by the various functional groups indicating the compliance rating of certain institutional units/processes/activities which include the Board of Directors. Management, Organizational and Procedural Controls, the Nomination Process, Independent Audit Mechanisms and Disclosure and Transparency among others. The evaluation process includes a self-assessment scorecard which is filled up by the Members of the Board. The above are submitted to the Compliance Officer who issues the required certificate of compliance with the corporate governance mechanism to the SEC. The Manual provides for a set of graduated penalties for non-compliance with/violations of its provisions. Because of the heightened sense of accountability among the staff and an enhanced culture of compliance within the whole bank, there have been no material deviations noted by the Compliance Officer.