**REPORT OF INDEPENDENT AUDITORS**

**The Board of Directors**
**ABC Manufacturing Company**
***(A Wholly Owned Subsidiary of***
***XYZ Holdings Corporation)***

123 Maganda Street
Future Village, Makati City [1]

We have audited the accompanying balance sheets of ABC Manufacturing Company as of December 31, 2005 and 2004, and the related statements of income, changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the 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 generally accepted auditing standards 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Manufacturing Company as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles in the Philippines.

**PUNONGBAYAN & ARAULLO**

**By: Gregorio S. Navarro**
Partner
CPA Reg. No. 0033571
TIN 109-228-435
PTR No. 4182116, January 4, 2006, Makati City
Partner SEC Accreditation No. 0013-AR-1
BIR AN 08-002511-2-2005 (Dec. 27, 2005 to 2008)

February 28, 2006

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[1] It is assumed that this set of financial statements is for submission to the SEC and BIR.

| | | | | |
|---|---|---|---|---|
| PAS 1.46 (a) | **ABC MANUFACTURING COMPANY** | | | |
| PAS 1.46 (b) | ***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)*** | | | |
| PAS 1.44 | **BALANCE SHEETS** | | | |
| PAS 1.46 (c) | **DECEMBER 31, 2005 AND 2004** | | | |
| PAS 1.46 (d) | ***(Amounts in Philippine Pesos)*** | | | |

| | | Notes [1] | **2005** | 2004 |
|---|---|---|---|---|
| | **A S S E T S** | | | |
| PAS 1.57 | **CURRENT ASSETS** | | | |
| PAS 1.68 (i) | Cash and cash equivalents | 4 | **P 16,642,248** | P 21,012,102 |
| PAS 1.68 (h) | Trade and other receivables - net | 5 | **25,653,977** | 21,789,826 |
| PAS 1.68 (d) | Financial assets at fair value through profit or loss | 6 | **32,210,910** | 48,344,082 |
| PAS 1.68 (g) | Inventories - net | 7 | **51,450,848** | 60,150,316 |
| PAS 1.69 | Prepayments | 8 | **14,659,138** | 11,160,815 |
| PAS 1.69 | Total Current Assets | | **140,617,121** | 162,457,141 |
| PAS 1.70 | **NON-CURRENT ASSETS** | | | |
| PAS 1.68 (h) | Trade and other receivables - net | 5 | **21,890,783** | 23,234,052 |
| PAS 1.68 (d) | Financial assets - net | 9 | **33,422,701** | 34,931,355 |
| PAS 1.68 (e) | Investments in subsidiaries and associates - net | 10 | **154,572,386** | 152,247,636 |
| PAS 1.68 (a) | Property, plant and equipment - net | 11 | **108,085,488** | 100,293,414 |
| PAS 1.68 (b) | Investment property | 12 | **19,516,594** | 16,756,936 |
| PAS 1.68 (c) | Intangible assets - net | 13 | **10,202,000** | 2,050,000 |
| PAS 1.68 (n) | Deferred tax assets - net | 23 | **9,349,608** | 12,725,709 |
| PAS 1.69 | Total Non-current Assets | | **357,039,560** | 342,239,102 |
| | **NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE** | 14 | **3,550,000** | - |
| PAS 1.69 | **TOTAL ASSETS** | | **P 501,206,681** | P 504,696,243 |

*Forward*

[1] Indicate only the main note. Reference to other accounts or disclosures should be done within the notes to FS.

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| | **LIABILITIES AND EQUITY** | | | |
| PAS 1.60 | **CURRENT LIABILITIES** | | | |
| | Interest-bearing loans and borrowings | 15 | **P 14,290,000** | P 16,652,700 |
| PAS 1.68 (j) | Trade and other payables | 16 | **49,088,013** | 61,448,625 |
| PAS 1.69 | Due to related parties | 24 | **17,977,826** | 29,364,993 |
| PAS 1.68 (m) | Income tax payable | | **2,314,212** | 4,210,321 |
| PAS 1.68 (k) | Provisions | 17 | **4,829,437** | 8,511,981 |
| PAS 1.69 | Total Current Liabilities | | **88,499,488** | 120,188,620 |
| PAS 1.57 | **NON-CURRENT LIABILITIES** | | | |
| PAS 1.68 (l) | Interest-bearing loans and borrowings | 15 | **54,820,000** | 57,700,000 |
| PAS 1.68 (k) | Retirement benefit obligation | 22 | **16,607,013** | 16,495,073 |
| PAS 1.68 (k) | Provisions | 17 | **5,681,513** | 6,206,683 |
| PAS 1.69 | Other non-current liabilities | | **2,853,277** | 3,766,066 |
| PAS 1.69 | Total Non-current Liabilities | | **79,961,803** | 84,167,822 |
| PAS 1.69 | Total Liabilities | | **168,461,291** | 204,356,442 |
| | **EQUITY** [2] | | | |
| PAS 1.68 (p) | Capital stock | 25 | **150,000,000** | 125,250,000 |
| | Additional paid-in capital | | **7,005,000** | 7,005,000 |
| | Treasury shares, at cost | | **( 1,000,000 )** | ( 1,000,000 ) |
| | Revaluation reserves | 2, 25 | **8,902,697** | 8,985,276 |
| PAS 1.68 (p) | Retained earnings | 2, 25 | **167,837,693** | 160,099,525 |
| PAS 1.69 | Total Equity | 2 | **332,745,390** | 300,339,801 |
| PAS 1.69 | **TOTAL LIABILITIES AND EQUITY** | | **P 501,206,681** | P 504,696,243 |

***See Notes to Financial Statements.***

[2] Major line items of equity (i.e., issued capital, reserves and retained earnings) should be presented on the face of the balance sheet. The various classes of this information, such as major items, the changes during the year and information on each class of share capital can be presented on the face of the balance sheet, statement of changes in equity, or in the notes.

PAS 1.46 (a)
PAS 1.46 (b)
PAS 1.44
PAS 1.46 (c)
PAS 1.46 (d)

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**STATEMENTS OF INCOME [1]**
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippine Pesos)***

| | | Notes [2] | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.81 (a) | **REVENUES** | | | |
| | Sale of goods | | **P 181,171,539** | P 156,982,596 |
| | Rendering of services | | **19,900,506** | 13,334,605 |
| | | | **201,072,045** | 170,317,201 |
| PAS 1.88 | **COST OF SALES AND SERVICES** | | | |
| PAS 2.36 (d) | Cost of sales | 18 | **100,110,007** | 68,331,945 |
| | Cost of services | 18 | **10,230,354** | 9,274,715 |
| | | | **110,340,361** | 77,606,660 |
| PAS 1.92 | **GROSS PROFIT** | | **90,731,684** | 92,710,541 |
| | **OTHER OPERATING EXPENSES (INCOME)** | | | |
| PAS 1.92 | Other operating income | 19 | **( 5,636,837 )** | ( 4,262,264 ) |
| PAS 1.92 | Selling and distribution costs | 20 | **23,829,851** | 20,545,136 |
| PAS 1.92 | Administrative expenses | 20 | **15,086,567** | 13,367,132 |
| PAS 1.92 | Other operating expenses | 19, 20 | **2,605,355** | 2,858,746 |
| | | | **35,884,936** | 32,508,750 |
| PAS 1.83 | **OPERATING PROFIT** | | **54,846,748** | 60,201,791 |
| | **OTHER INCOME (CHARGES)** | | | |
| PAS 1.81 (b) | Finance costs | 21 | **( 11,110,130 )** | ( 10,929,530 ) |
| | Other gains (losses) - net | 21 | **( 1,531,260 )** | 1,378,911 |
| | | | **( 12,641,390 )** | ( 9,550,619 ) |
| PAS 1.83 | **INCOME BEFORE TAX** | | **42,205,358** | 50,651,172 |
| PAS 1.81 (e) | **TAX EXPENSE** | 23 | **13,257,942** | 16,318,782 |
| PAS 1.81 (f) | **NET INCOME** | 2 | **P 28,947,416** | P 34,332,390 |

***See Notes to Financial Statements.***

[1] This format for statements of income illustrates an example of the "function of expense" or "cost of sales" method. See Appendix 1.1 for the format illustrating the "nature of expense" method.

[2] Indicate only the main note. Reference to other accounts or disclosures should be done within the notes to FS.

PAS 1.46 (a)
PAS 1.46 (b)
PAS 1.44
PAS 1.46 (c)
PAS 1.46 (d)

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**STATEMENTS OF CHANGES IN EQUITY** [1]
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippine Pesos)***

| PAS ref. | | Notes [2] | 2005 | 2004 |
|---|---|---|---|---|
| | **CAPITAL STOCK** [3] | 25 | | |
| | Balance at beginning of year | | **P 125,250,000** | P 125,250,000 |
| | Additional issuance during the year | | **24,750,000** | - |
| | Balance at end of year | | **150,000,000** | 125,250,000 |
| | **ADDITIONAL PAID-IN CAPITAL** | | **7,005,000** | 7,005,000 |
| | **TREASURY SHARES -** At Cost | | **( 1,000,000 )** | ( 1,000,000 ) |
| | **REVALUATION RESERVES** | 25 | | |
| PAS 1.97 (b) | Balance at beginning of year | | | |
| | As previously reported | | **9,344,190** | 5,270,018 |
| PAS 1.96 (d) | Effects of transition to PFRS, net of taxes | 2 | **( 358,914 )** | ( 291,295 ) |
| | As restated | | **8,985,276** | 4,978,723 |
| PAS 1.96 (b) | Depreciation transfer for building improvements - net of tax | | **( 770,752 )** | ( 806,326 ) |
| PAS 1.96 (b) | Fair value gains, net of taxes | | **688,173** | 4,812,879 |
| PAS 1.97 (b) | Balance at end of year | | **8,902,697** | 8,985,276 |
| | **RETAINED EARNINGS** | 25 | | |
| PAS 1.97 (b) | Balance at beginning of year | | | |
| | As previously reported | | **274,880,340** | 202,132,908 |
| PAS 1.96 (d) | Effects of transition to PFRS, net of taxes | 2 | **( 114,780,815 )** | ( 63,617,499 ) |
| | As restated | | **160,099,525** | 138,515,409 |
| PAS 1.97 (a) | Cash dividends | 25 | **( 21,980,000 )** | ( 13,554,600 ) |
| PAS 1.96 (b) | Depreciation transfer for building improvements - net of tax | | **770,752** | 806,326 |
| PAS 1.96 (a) | Net income | | **28,947,416** | 34,332,390 |
| PAS 1.97 (b) | Balance at end of year | | **167,837,693** | 160,099,525 |
| PAS 1.97 (b) | **TOTAL EQUITY** | 2 | **P 332,745,390** | P 300,339,801 |
| | **Net Gain (Loss) Recognized Directly in Equity** | | **P 688,173** | P 4,812,879 |

***See Notes to Financial Statements.***

[1] Refer to Appendix 1.2 for proposed format when there are several equity items to be presented in the Statement of Changes in Equity.

[2] Indicate only the main note. Reference to other accounts or disclosures should be done within the notes to FS.

[3] If there are only few details, show on the face of the statement the number of authorized, issued, and subscribed shares and par value.

PAS 1.46 (a)
IAS 1.46 (b)
IAS 1.44
IAS 1.46 (c)
IAS 1.46 (d)

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippine Pesos)***

| | | | 2005 | | 2004 |
|---|---|---|---|---|---|
| IAS 7.10 | **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| | Income before tax | **P** | **42,205,358** | P | 50,651,172 |
| | Adjustments for: | | | | |
| | Depreciation and amortization | | **15,648,286** | | 13,523,806 |
| | Impairment losses | | **11,407,390** | | 7,856,842 |
| | Interest expense | | **11,110,130** | | 10,929,530 |
| | Interest income | | **( 5,537,873 )** | | ( 4,545,194 ) |
| | Changes in fair values | | **4,153,264** | | 3,883,310 |
| | Amortization of intangible assets | | **2,528,000** | | 1,850,000 |
| | Unrealized foreign currency losses | | **2,403,286** | | 1,230,125 |
| | Dividend income | | **( 1,450,000 )** | | ( 1,450,000 ) |
| | Gains on disposals of property and equipment | | **( 206,284 )** | | - |
| | Operating income before working capital changes | | **82,261,557** | | 83,929,591 |
| | Increase in trade and other receivables | | **( 2,520,882 )** | | ( 6,069,149 ) |
| | Decrease (increase) in inventories | | **8,699,468** | | ( 7,020,652 ) |
| | Decrease (increase) in prepayments | | **( 3,498,323 )** | | 211,596 |
| | Decrease in trade and other payables | | **( 12,360,612 )** | | ( 2,085,833 ) |
| | Increase (decrease) in other non-current liabilities | | **1,087,211** | | ( 3,875,290 ) |
| | Increase in retirement benefit obligations | | **111,940** | | 8,996 |
| | Decrease in provisions | | **( 1,661,399 )** | | ( 1,917,206 ) |
| | Cash generated from operations | | **72,118,960** | | 63,182,053 |
| IAS 7.31 | Interest paid | | **( 1,300,750 )** | | ( 3,930,013 ) |
| IAS 7.35 | Cash paid for income taxes | | **( 15,483,068 )** | | ( 18,000,303 ) |
| | Net Cash From Operating Activities | | **55,335,142** | | 41,251,737 |
| IAS 7.10 | **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| | Acquisitions of property, plant and equipment | | **( 27,521,420 )** | | ( 18,537,820 ) |
| | Increase in financial assets at fair value through profit or loss | | **15,376,172** | | ( 4,356,098 ) |
| | Additions to intangible assets | | **( 10,680,000 )** | | - |
| | Additions to investments in an associate | | **( 5,000,000 )** | | - |
| | Acquisition of investment property | | **( 1,019,316 )** | | - |
| | Proceeds from sale of property, plant and equipment | | **3,087,344** | | - |
| | Dividends received from subsidiaries and associate | | **1,450,000** | | 1,450,000 |
| | Interest received | | **1,454,117** | | 572,150 |
| IAS 7.31 | Acquisitions of available-for-sale financial assets | | **( 1,200,645 )** | | - |
| | Collections of receivable from a finance lease | | **1,163,009** | | 1,500,689 |
| | Net Cash Used in Investing Activities | | **( 22,890,739 )** | | ( 19,371,079 ) |

*Forward*

| | | 2005 | 2004 |
|---|---|---|---|
| IAS 7.10 | **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| | Borrowing repayments | ( 24,647,090 ) | ( 16,533,025 ) |
| | Repayment of amounts due to related parties | ( 29,076,116 ) | ( 30,538,892 ) |
| | Proceeds from issuance of shares of stock | 24,750,000 | - |
| | Cash dividends paid | ( 21,980,000 ) | ( 13,554,600 ) |
| | Proceeds from additional borrowings | - | 14,569,812 |
| | Additional borrowings from related parties | 14,138,949 | 25,265,885 |
| | Net Cash Used in Financing Activities | ( 36,814,257 ) | ( 20,790,820 ) |
| IAS 7.45 | **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | ( 4,369,854 ) | 1,089,838 |
| | **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 21,012,102 | 19,922,264 |
| | **CASH AND CASH EQUIVALENTS AT END OF YEAR** | P 16,642,248 | P 21,012,102 |

**Supplemental Information on Noncash Investing Activity**

Certain transportation equipment with carrying amounts of P1.4 million and P1.6 million as of December 31, 2005 and 2004, respectively, are carried under finance leases (see Notes 11 and 27).

***See Notes to Financial Statements.***

PAS 1.46 (a)
PAS 1.46 (b)
PAS 1.46
PAS 1.46 (c)
PAS 1.46 (d)
PAS 1.46 (e)

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**NOTES TO FINANCIAL STATEMENTS**
**DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippines Pesos)***

## 1. CORPORATE INFORMATION

PAS 1.126 (b)

ABC Manufacturing Company (the "Company"[1]) was incorporated in the Philippines on June 29, 1976. The Company is presently engaged in the manufacture, distribution and installation of integrated circuits, conventional and surface mount printed circuit boards and other similar products.

PAS 1.126 (c)

The Company is a wholly owned subsidiary of XYZ Holdings Corporation (XYZ)[2], a company incorporated and domiciled in the Philippines. XYZ is presently engaged in the manufacture and distribution of electronic components, the manufacture and installation of insulation products, and the manufacture and sale of ready-to-wear clothes.

PAS 1.126 (a)
PAS 1.126 (c)

The Company's registered office[3], which is also its principal place of business, is located at 123 Maganda Street, Future Village, Makati City. The registered office of XYZ[4] is located at 90 Amihan Street, Somewhere There Avenue, Pasay City.

PAS 1.46 (c)
PAS 10.17

The financial statements of the Company for the year ended December 31, 2005 (including the comparatives for the year ended December 31, 2004) were authorized for issue by the Board of Directors on March 31, 2006.[5]

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[1] Or "ABC," however, the term chosen should be used consistently within the notes to financial statements.

[2] The name of the parent company and the ultimate parent company (if any) of the group should be disclosed.

[3] Or principal place of business, if different from the registered address.

[4] Disclosure of the registered office of the parent company and the ultimate parent (if any) is only required if the Company does not present consolidated financial statements.

[5] Refer to AAR 04-03 for discussion on the relationship of the date of client's authorization for the issuance of the financial statements and the date of the auditors' report thereon.

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PAS 1.14

## 2. TRANSITIONING TO PHILIPPINE FINANCIAL REPORTING STANDARDS[6]/[7]

The Accounting Standards Council (ASC), the accounting standards-setting body in the Philippines, started a program in 1997 to move fully to the International Accounting Standards (IASs) issued by the then International Accounting Standards Committee (IASC). In April 2001, IASC was succeeded by the International Accounting Standards Board (IASB) which since then has issued revised IASs and new International Financial Reporting Standards (IFRSs).

To correspond better with the issuances of the IASB, the ASC re-named the Standards it issues as Philippine Financial Reporting Standards or PFRSs (previously referred to as Statements of Financial Accounting Standards or SFASs). PFRSs consist of:

a. PFRSs (corresponding to IFRSs);
b. Philippine Accounting Standards or PASs (corresponding to IASs); and,
c. Interpretations (corresponding to IFRICs and SICs).

In compliance with the pronouncements of the ASC and the regulations of the Securities and Exchange Commission (SEC), the Company has adopted all the relevant PFRSs for the first time in its financial statements for the year ended December 31, 2005, with January 1, 2004 as its transition date. The transition from the previous generally accepted accounting principles (GAAP) in the Philippines to PFRSs has been made in accordance with PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*.

Except for the requirements of PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, the Company's financial statements for 2005 and the comparatives presented for 2004 comply with all presentation and disclosure requirements of the relevant PFRSs applicable for accounting periods commencing on or after January 1, 2005. As required by PFRS 1, PFRS 5 was applied in accordance with its specific transitional provisions, prospectively starting on the 2005 accounts only.

Due to the transition to PFRS, the 2004 comparatives contained in these financial statements differ from those previously presented in the financial statements for the year ended December 31, 2004.[8]

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[6] The discussion of the transition to PFRS as required by PFRS 1 needs to be disclosed only in the first financial statements after the new or revised rules have been adopted by the entity.

[7] It may happen that an entity, in its 2004 financial statements under the previous GAAP, adopted revised PASs that became effective in January 2004 (for example, PAS 17 on Leases) which adoption resulted in material adjustments (taken to the beginning retained earnings or to the profit and loss in 2004). In those cases, there is no need to repeat in this Note 2 (or in another note) the discussion of the changes previously included in the 2004 FS. Instead, if deemed necessary, the adjustments taken to the beginning retained earnings or to the profit and loss in 2004 can be explained in the relevant notes on the accounts affected (e.g., note on retained earnings, taxes, etc.).

[8] The nature, amount of, and reason for, any reclassification of comparative amounts should be disclosed. When it is impracticable to reclassify comparative amounts, the reason for not reclassifying and the nature of the changes that would have been made if amounts were reclassified should be disclosed.

The following reconciliations[9] and explanatory notes thereto describe the effects of the transition on the Company's opening PFRS balance sheet as of January 1, 2004 and for the year ended December 31, 2004. All explanations should be read in conjunction with the PFRS accounting policies of the Company as disclosed in Note 3.

No adjustments to share and additional paid-in capital were necessary in the opening PFRS balance sheet as of January 1, 2004 and the comparatives prepared for the year ended December 31, 2004.[10]

### *2.1 Reconciliations*[11]

PAS 1.105 (b)
PAS 1.108 (b)

a. The reconciliations of the Company's equity[12] reported under previous Philippine GAAP to its equity under PFRS are summarized as follows:

| | Notes | December 31, 2004 | January 1, 2004 |
|---|---|---|---|
| **Revaluation Reserves under previous GAAP** | | **P 9,344,190** | **P 5,270,018** |
| Remeasurement of available-for-sale financial assets | 2.4 | 229,102 | ( 428,375) |
| Fair value adjustment of investment property | 2.6 | ( 1,320,436) | - |
| Deferred tax adjustments | 2.9 | 732,420 | 137,080 |
| Total adjustments to revaluation reserves | | ( 358,914) | ( 291,295) |
| **Revaluation Reserves under PFRS, balance carried forward** | | **P 8,985,276** | **P 4,978,723** |

[9] If the transition to PFRSs did not result in material adjustments to financial statement account balances, disclosure should be made of this fact, including any revision in the structure and format of the financial statements, material reclassifications, or changes in designations of assets and liabilities. Reference can be made to another note that discusses in more detail the changes made.

[10] If there are adjustments in the entity's capital stock and paid-in capital, revise this note and include the impact in the reconciliation of equity.

[11] PFRS 1.41 requires that where a first-time adopter becomes aware of errors made under previous GAAP, the reconciliations should distinguish between the correction of those errors and changes in accounting policies. Note: The correction of an error has not been included in this example.

[12] If the entity will present 2-year comparatives, the above reconciliations should show figures for December 31, 2004, December 31, 2003 and January 1, 2003.

| | Notes | December 31, 2004 | January 1, 2004 |
|---|---|---|---|
| **Revaluation Reserves under PFRS, balance brought forward** | | **P 8,985,276** | **P 4,978,723** |
| **Retained Earnings under previous GAAP** | | **274,880,340** | **202,132,908** |
| Remeasurement of refundable security deposits | 2.3 | ( 12,562,985) | ( 13,533,030) |
| Fair value adjustment of available-for-sale financial assets | 2.4 | ( 1,197,477) | - |
| Reversal of equity in net earnings of subsidiaries and associates | 2.5 | ( 84,433,625) | ( 38,061,909) |
| Fair value adjustment of investment property | 2.6 | 1,320,436 | - |
| Recognition of restoration costs of leased property | 2.7 | ( 1,860,215) | ( 1,194,158) |
| Recognition of transitional liability and defined benefit expense | 2.8 | ( 21,799,613) | ( 16,486,077) |
| Deferred tax adjustments | 2.9 | 5,752,644 | 5,657,675 |
| Total adjustment to retained earnings | | ( 114,780,815) | ( 63,617,499) |
| **Retained Earnings under PFRS** | | **160,099,525** | **138,515,409** |
| Total adjustments to Equity | | ( 115,139,729) | ( 63,908,794) |
| **Equity under previous GAAP** | | **415,479,530** | **338,657,926** |
| **Equity under PFRS** | | **P 300,339,801** | **P 274,749,132** |

IFRS 1.39 (a)
IFRS 1.45 (b)

b. The remeasurements of balance sheet items at the opening PFRS balance sheets as of January 1, 2004 and comparative financial year as of December 31, 2004 are summarized as follows:[13]

| | Notes | Previous GAAP | Effects of Transition | PFRS |
|---|---|---|---|---|
| **January 1, 2004** | | | | |
| **Changes in assets:** | | | | |
| Marketable equity securities | 2.2,2.4 | P 36,458,612 | (P 36,458,612) | P - |
| Financial assets at fair value through profit or loss | 2.2 | - | 32,093,244 | 32,093,244 |
| Non-current trade and other receivables | 2.2, 2.3 | 53,788,272 | 6,466,970 | 60,255,242 |
| Non-current financial assets | 2.2, 2.4 | 26,589,723 | 3,936,993 | 30,526,716 |
| Investments in subsidiaries and associates | 2.5 | 191,365,879 | ( 38,061,909) | 153,303,970 |
| Property, plant and equipment | 2.2, 2.6, 2.7 | 105,002,355 | ( 15,486,155) | 89,516,200 |
| Investment property | 2.2, 2.6 | - | 16,756,936 | 16,756,936 |
| Deferred tax assets | 2.9 | 6,223,797 | 6,527,175 | 12,750,972 |
| Other non-current assets | 2.2, 2.3 | 20,000,000 | ( 20,000,000) | - |
| | | 439,428,638 | ( 44,225,358) | 395,203,280 |
| **Changes in liabilities:** | | | | |
| Retirement benefit obligation | 2.8 | - | 16,487,077 | 16,487,077 |
| Non-current provisions | 2.7 | 13,438,511 | 3,197,359 | 16,635,870 |
| | | P 426,990,127 | | P 362,080,333 |
| **Total adjustment to equity** | | | **P 63,908,794** | |
| **December 31, 2004** | | | | |
| **Changes in assets:** | | | | |
| Marketable equity securities | 2.2, 2.4 | P 16,250,838 | (P 16,250,838) | P - |
| Financial assets at fair value through profit or loss | 2.2 | - | 48,344,082 | 48,344,082 |
| Non-current trade and other receivables | 2.2, 2.3 | 35,797,037 | ( 12,562,985) | 23,234,052 |
| Non-current financial assets | 2.2, 2.4 | 67,992,974 | ( 33,061,619) | 34,931,355 |
| Investments in subsidiaries and associates | 2.5 | 236,681,261 | ( 84,433,625) | 152,247,636 |
| Property, plant and equipment | 2.2, 2.6, 2.7 | 90,104,950 | 10,188,464 | 100,293,414 |
| Investment property | 2.2, 2.6 | - | 16,756,936 | 16,756,936 |
| Deferred tax assets | 2.9 | 6,240,626 | 6,485,083 | 12,725,709 |
| Other non-current assets | 2.2 | 25,192,600 | ( 25,092,600) | - |
| | | 478,260,285 | ( 89,727,101) | 388,533,184 |
| **Changes in liabilities:** | | | | |
| Retirement benefit obligation | 2.9 | - | 21,799,613 | 16,495,073 |
| Non-current provisions | 2.7 | 2,593,668 | 3,613,015 | 6,206,683 |
| | | P 475,666,617 | | P 365,831,428 |
| **Total adjustment to equity** | | | **(P115,139,729)** | |

IFRS 1.39 (a)
IFRS 1.45 (b)

[13] If the entity will present 2-year comparatives, the above reconciliations should show figures for December 31, 2004, December 31, 2003 and January 1, 2003.

PFRS 1.39 (b)

c. Profit and loss reported under previous GAAP for the year ended December 31, 2004 is reconciled to profit and loss under PFRS as follows:[14]

| | Notes | Previous GAAP | Effects of Transition | PFRS |
|---|---|---|---|---|
| **Revenues** | | **P 170,317,201** | **P -** | **P 170,317,201** |
| Costs of sales and services | 2.7, 2.8 | 73,887,185 | 3,719,475 | 77,606,660 |
| Other operating expenses | 2.7, 2.8 | 30,664,289 | 1,844,461 | 32,508,750 |
| **Operating profit** | | **65,765,727** | **5,563,936** | **60,201,791** |
| **Other income (charges):** | | | | |
| Finance costs | 2.2, 2.7 | ( 11,899,575 ) | ( 970,045) | ( 10,929,530) |
| Equity share in net earnings | 2.5 | 46,371,716 | ( 46,371,716) | - |
| Other gains (losses) – net | 2.2, 2.4 | 1,534,528 | ( 155,617) | 1,378,911 |
| | | 36,006,669 | ( 45,557,288) | ( 9,550,619) |
| **Income before tax** | | **101,772,396** | **( 51,121,224)** | **50,651,172** |
| Tax expense | 2.9 | 16,276,690 | 42,092 | 16,318,782 |
| **Net Income** | | **P 85,495,706** | **(P51,163,316)** | **P 34,332,390** |

### *2.2 Revised Structure of Balance Sheet and Statement of Income*

The Company has modified its previous balance sheet and statement of income structure on transition to PFRS. The main changes are summarized as follows:

a. Assets classified as marketable securities under the previous GAAP are now presented under a separate balance sheet line item Financial Assets at Fair Value through Profit or Loss;

b. Assets classified as long-term investments under previous GAAP are now presented under a separate balance sheet line item Financial Assets under the non-current assets. The non-current financial assets include held-to-maturity and available-for-sale financial assets;

c. Refundable security deposit presented as part of Other Non-current Assets under the previous GAAP is now presented under non-current portion of Trade and Other Receivables;

d. Land solely held for investment purposes by the Company was reclassified from Property, Plant and Equipment as presented under previous GAAP to the separate balance sheet line item Investment Property; and,

[14] If the entity will present 2-year comparatives, the above reconciliations should show figures for December 31, 2004 and 2003.

e. Costs and other operating expenses presented by function and nature in the statement of income under the previous GAAP are now presented by function in the statement of income and breakdown of expenses by nature is disclosed in the notes to the financial statements.

In addition, some balance sheet items that previously were classified as non-current in accordance with previous GAAP requirements are now presented as current under PFRS.

Individual notes to the balance sheet items and the accounting policies provide further details on these changes.

### *2.3 Measurement of Security Deposit at Amortized Cost*

Refundable security deposit arising from the lease of warehouses from a third party was measured under the previous GAAP at the amount of consideration given to the lessor amounting to P20 million. Under PFRS, the refundable deposit is considered as loans and receivable financial asset measured at amortized cost using the effective interest rate method. The discount rate used of 15% was determined by reference to the market interest rate of comparable financial instrument at the date of the inception of the lease. This resulted in the recognition of day-one loss amounting to P15,056,306 and interest income of P1,523,276 in the retained earnings as of January 1, 2004. The related interest income recognized in 2004 amounted to P970,045 which resulted in the increase in net income for that year. The net adjustment to the beginning retained earnings as of December 31, 2004 amounted to P12,562,985.

### *2.4 Fair Value Measurement of Financial Assets*

Investment in convertible bonds under the previous GAAP was measured at amortized cost. Under PFRS, these financial assets were classified as available-for-sale, presented under the non-current Financial Assets account in the balance sheet, which is measured at fair value. This resulted in the recognition of losses on changes in fair value amounting to P428,375 in the January 1, 2004 opening PFRS balance sheet and P540,000 in December 31, 2004. The losses on changes in fair value are recorded under the Revaluation Reserves in the equity section of the balance sheets.

Certain equity securities classified as marketable securities under the previous GAAP were reclassified as available-for-sale financial assets. There is no adjustment to the opening PFRS balance sheet since both classifications are measured at fair value. However, the change in the fair value of the available-for-sale financial assets is charged to Revaluation Reserves in the equity section of the balance sheets. Accordingly, the gain on change in fair value of this asset in 2004 amounting to P1,197,477 was transferred from Other Income in the statements income to Revaluation Reserves.

### *2.5 Remeasurement of Equity Investments at Cost*

Under the previous GAAP, investments in subsidiaries and associates were accounted for at cost, plus the Company's equity in net earnings and other changes in its share in net assets of the investee from date of acquisition, less any impairment in value. These investments are now accounted for by the Company at cost in its separate financial statements as allowed under PFRS. This resulted in the reversal of the previously recognized equity in net earnings of the subsidiaries and associates against the Company's retained earnings as of January 1, 2004 and 2005 amounting to P38,061,909 and P84,433,625, respectively. This also reduced the reported net income in 2004 by P46,671,716.

### *2.6 Classification and Measurement of Investment Property at Fair Value*

Under the previous GAAP, the Company's investment property previously classified as property, plant and equipment were measured using the fair value model and any gain or loss arising from the change in fair value was charged to equity. Under PFRS, however, the fair value remeasurement of the investment property is now performed annually and any gain or loss from the remeasurement is charged to profit or loss for the period. As the Company's investment property was already stated at revalued amount as of December 31, 2003, no valuation adjustment was necessary in the PFRS opening balance sheet. The gain on change in fair value of investment property as of December 31, 2003 amounting to P2,500,000 was retained in the Revaluation Reserves account in the equity section of the balance sheet (see Note 25.2). This will be charged to profit or loss upon disposal of the investment property. In 2004, the gain on change in fair value of investment property amounting to P1,320,436 previously charged to Revaluation Reserves under the previous GAAP was transferred to the Other Income account in the statement of income.

### *2.7 Recording of Restoration Costs of Property, Pant and Equipment*

The lease agreement on certain warehouses requires the Company to restore the leased asset to its original state at the end of the 10-year lease term in 2012. Under the previous GAAP, the restoration cost is not recognized until it is incurred. However, under the relevant PFRS, a provision is recognized for the present value of the costs to be incurred for the restoration of the leased warehouses. The total estimated cost to be incurred at the end of lease term amounted to P8.5 million. The present value of the restoration cost at the inception of the contract amounting to P2,504,001 was capitalized in January 1, 2004 as part of the leasehold improvements under the Property, Plant and Equipment account in the balance sheet. Annual amortization of restoration cost amounted to P250,800. The net adjustment to the retained earnings as of January 1, 2005 and 2004 amounted to P1,860,215 and P1,194,158, respectively.

### *2.8 Full Recognition of Defined Benefit Obligation*

Under PFRS, the Company's obligation under post-employment defined benefit plan should be actuarially determined using projected unit credit method. The adoption of the related new standard resulted in the recognition of transitional liability amounting to P16,486,077 as of January 1, 2004. This transitional liability was fully recognized retrospectively in the Company's opening PFRS balance sheet. This also resulted in the recognition of additional defined benefit expense in 2004 amounting to P5,313,536. The total adjustments to the retained earnings as of January 1, 2005 and 2004 amounted to P21,799,613 and P16,486,077, respectively.

### *2.9 Deferred Tax Adjustments*

The deferred tax expense recognized by the Company which relates to the temporary differences arising from PFRS adjustments amounted to P8,537,939 in December 2004 and P5,794,755 in January 2004. The deferred tax expense adjusted to the beginning retained earnings and revaluation reserve account in equity amounted to P7,805,519 and P732,420, respectively, in 2005 and P5,657,675 and P137,080, respectively, in 2004.

PAS 1.108 (b)

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### *3.1 Basis of Preparation*

PAS 1.14

The financial statements of ABC Manufacturing Company have been prepared in accordance with generally accepted accounting principles in the Philippines as set forth in PFRSs.

The financial statements have been prepared on the historical cost basis, except for the revaluation of certain financial assets, property, plant and equipment and investment property. The measurement bases are more fully described in the accounting policies below.

The accounting estimates and assumptions are used in preparing the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.[15]

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

[15] The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements should be disclosed, hence, the above paragraph should be modified accordingly.

PAS 8.30

### *3.2 Impact of New and Revised Accounting Standards Effective Subsequent to 2005*[16]

There are new and revised accounting standards, amendments and interpretations to existing standards that have been published by IASB and adopted by the ASC which are mandatory for accounting periods beginning on or after January 1, 2006. These standards, which the Company has not opted to adopt early, are as follows[17]:

| | | |
|---|---|---|
| 2006 | | |
| PAS 19 (Amendment) | : | Employee Benefits |
| PAS 39 (Amendment) | : | The Fair Value Option |
| PAS 39 and PFRS 4 (Amendment) | : | Financial Guarantee Contracts |
| PFRS 1 (Amendment)[18] | : | First-time Adoption of Philippine Financial Reporting Standards |
| PFRS 6 | : | Exploration for and Evaluation of Mineral Resources |
| IFRIC 4 | : | Determination whether an Arrangement Contains a Lease |
| IFRIC 5 | : | Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds |
| IFRIC 6 | : | Liabilities Arising from Participating in a Specific Market |
| 2007 | | |
| PAS 1 (Amendment)[19] | : | Presentation of Financial Statements |
| PFRS 7 | : | Financial Instruments: Disclosures |

The Company will apply the relevant new accounting standards in 2006 and 2007 in accordance with their transitional provisions. It is currently evaluating the impact of those standards on its financial statements and has initially determined that the following new standards may have significant effects on the financial statements for 2006, as well as for prior and future periods: (***Include here brief discussions on the relevant standards that are expected to have material effects on the Company's FS, using the format of the samples given below. These are samples only should be reworded to consider the specific circumstances of the client.***)

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16 When any of the new accounting standards is applied early (i.e., before January 1, 2006), that fact should be disclosed, together with the other information required under the specific standard.

17 Alternatively, the note may mention only those that are relevant to the Company; in this case, the sentence will be: "*Of the new ASC pronouncements, the following standards are relevant to the Company, which the Company has not opted to adopt early*". Then the standards to be included in the list shall show only those relevant standards that will be applied by the Company subsequent to 2005.

18 The amendment in PFRS 1 is in conjunction with the adoption of PFRS 6.

19 This is a complementary amendment resulting from the adoption of PFRS 7.

- PAS 19 (Amended), *Employee Benefits*. This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It imposes additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Company does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment will only impact the format and extent of disclosures presented in the accounts. The Company will apply this amendment for annual periods beginning January 1, 2006.

- PAS 39 (Amended), *The Fair Value Option*. This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment will not have a significant impact on the classification of financial instruments, as the Company would be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Company will apply this amendment for annual periods beginning January 1, 2006.

- PFRS 7, *Financial Instruments: Disclosures* and complementary amendment to PAS 1. PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company has assessed the impact of PFRS 7 and the amendment to PAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of PAS 1. The Company will apply PFRS 7 and the amendment to PAS 1 for annual periods beginning January 1, 2007.

- IFRIC 4, *Determining whether an Arrangement contains a Lease*. IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset; and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of IFRIC 4 on the Company's operations.

As for the other new accounting standards, the Company has initially assessed that they will not result in significant changes to the amounts or disclosures in its financial statements.

PAS 27.41 (a) (b)

### *3.3 Separate Financial Statements[20] and Investments in Subsidiaries and Associates*

These financial statements are prepared as the Company's separate financial statements. The Company did not present consolidated financial statements because it is a wholly owned subsidiary of XYZ which presents consolidated financial statements. In accordance with PAS 27, *Consolidated and Separate Financial Statements,* a parent that is a wholly owned subsidiary need not present consolidated financial statements[21].

PAS 27.37
PAS 39.66

The Company's investments in subsidiaries and associates are accounted for in these separate financial statements at cost,[22] less any impairment loss. If there is an objective evidence that the investments in subsidiaries and associates will not be recovered, an impairment loss is provided. Impairment loss is measured as the difference between the carrying amount of the investment and the present value of the estimated cash flows discounted at the current market rate of return for similar financial asset. The amount of the impairment loss is recognized in profit or loss.

PAS 27.12
PAS 27.14

Subsidiaries are entities over which the Company has the power to govern the financial reporting policies generally accompanying a shareholding of more than one half of the voting rights. The Company obtains and excises control through voting rights. The existence and effect of potential voting rights that are currently exercisable and convertible are considered when assessing whether the Company controls another entity.

PAS 28.13

Associates are those entities over which the Company is able to exert significant influence but which are neither subsidiaries nor interests in a joint venture.

PAS 1.110
PAS 7.46

### *3.4 Cash and Cash Equivalents*

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

### *3.5 Financial Assets*

PAS 1.108 (b)

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

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[20] See Appendix for sample disclosures on certain items if what are presented are not separate FS (i.e., consolidated or investor's financial statements).

[21] PAS 27.10 provides the exemption criteria when a parent need not present consolidated financial statements.

[22] Alternatively, these investments may be accounted for under PAS 39.

PAS 32.61
PAS 32.60 (b)

All financial assets are recognized on their trade date. All financial assets that are not classified as at fair value through profit or loss are initially recognized at fair value, plus transaction costs.

PAS 1.110
PAS 32.60
PAS 39.9

- *Financial Assets through Profit or Loss.* This category include financial assets that are either classified as held for trading or are designated by the entity to be carried at fair value through profit or loss upon initial recognition.[23] A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as 'held for trading' unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

  Subsequent to initial recognition, the financial assets included in this category are measured at fair value with changes in fair value recognized in profit or loss. Financial assets originally designated as financial assets at fair value through profit or loss may not subsequently be reclassified.

- *Loans and Receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the receivables. They are included in current assets, except for maturities greater than 12 months after the balance sheet date which are classified as non-current assets.

  Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment losses. Any change in their value is recognized in profit or loss.

  Loans and receivables are presented as Trade and Other Receivables in the balance sheets.

  Impairment loss is provided when there is objective evidence that the Company will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the asset's carrying amount and the present value of estimated cash flows.

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[23] In addition, if an entity has derivative financial instruments that do not qualify for hedge accounting, these derivative financial instruments are classified as held for trading and additional disclosures as required by PAS 32 for derivatives should be included in the notes to financial statements.

[24] If the fair value is determined through valuation technique, disclose that fact. Refer to PAS 32. 92 for guidance.

- *Held-to-maturity Investments.* This includes non-derivative financial assets with fixed or determinable payments and a fixed date of maturity. Investments are classified as held-to maturity if the Company has the positive intention and ability to hold them until maturity. Investments intended to be held for an undefined period are not included in this classification. They are included in non-current assets under Long-term Financial Assets account in the balance sheets, except those maturing within 12 months of the balance sheet date.
  Held-to-maturity investments are subsequently measured at amortized cost using the effective interest method. In addition, if there is objective evidence that the investment has been impaired, the financial asset is measured at the present value of estimated cash flows. Any changes to the carrying amount of the investment are recognized in profit or loss.

- *Available-for-sale Financial Assets.* This include non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. They are included in non-current assets under the Long-term Financial Assets account in the balance sheets unless management intends to dispose of the investment within 12 months of the balance sheet date.

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

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

PAS 39
AG 72 to 74

For investments that are actively traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.[24]

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

PAS 32.66 (c)

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

### *3.6 Inventories*

PAS 2.36 (a)
PAS 1.108 (a)

At the balance sheet date, inventories are valued at the lower of cost and net realizable value.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

- Raw materials – purchase cost on a first-in, first-out basis; and,
- Finished goods and work-in-process – cost of direct materials and labor and a proportion of manufacturing overheads based on normal operating capacity, excluding borrowing cost.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

### *3.7 Property, Plant and Equipment*[25]

PAS 1.110

PAS 16.73 (a)

Land and buildings and improvements are measured at fair value less depreciation for buildings and improvements. All other property, plant and equipment are stated at cost less accumulated depreciation and impairment in value.

The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, their cost and related accumulated depreciation and impairment losses are removed from the accounts and any resulting gain or loss is reflected in income for the period.

PAS 16.39

Following initial recognition at cost, land and buildings and improvements are carried at revalued amounts which are the fair values at the date of the revaluation, as determined by independent appraisers, less any subsequent accumulated depreciation (on buildings and improvements) and accumulated impairment losses. Fair value is determined by reference to market–based evidence, which is the amount for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction as at the valuation date. Any revaluation surplus is credited to the Revaluation Reserves account included in the equity section of the balance sheet. Any revaluation deficit directly offsetting a previous surplus in the same asset is directly offset against Revaluation Reserves. Annually, an amount from the Revaluation Reserves is transferred to retained earnings for the depreciation relating to the revaluation surplus. Additionally, accumulated depreciation as at revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings. Revaluations are performed every three years ensuring that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

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[25] See Appendix 2.3 for the sample disclosure of PPE measured using cost model.

PAS 16.73 (b)

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

PAS 16.73 (c)

| | |
|---|---|
| Buildings and improvements | 10-20 years |
| Machinery and equipment | 5-12 years |
| Office furniture, fixtures and other equipment | 5-10 years |
| Transportation equipment | 3-5 years |

Transportation equipment held under finance lease agreements (see Note 3.14) are depreciated over their expected useful lives (determined by reference to comparable owned assets) or over the term of lease, if shorter.

PAS 36.59

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 3.16).

PAS 16.51

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

PAS 16.68, 71

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

PAS 40.75 (a) (d) (e)

### *3.8 Investment Property*

Investment property is stated at fair value[26] as determined by independent appraisers. The carrying amounts recognized in the balance sheet reflect the prevailing market conditions at the balance sheet date.

PAS 1.108 (b)

Any gain or loss resulting from either a change in the fair value or the sale of an investment property is immediately recognized in profit or loss as Changes in Fair Value of Investment Property.

### *3.9 Intangible Assets*[27]

PAS 38.118 (a)
PAS 38.118 (b)

Intangible assets include acquired licenses, franchises and internally developed software used in production and administration which are accounted for under the cost model. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given to acquire an asset at the time of its acquisition or production. Capitalized costs are amortized on a straight-line basis over the estimated useful lives (ranging from 3 to 10 years) as these intangible assets are considered finite. In addition, other intangible assets are subject to impairment testing as described in Note 3.16.

[26] Investment property may be measured using the cost model (PAS 40.75). If cost model is used, disclose the fair value of the investment property.

[27] The rebuttable presumption under SFAS 38/IAS 38 that the ceiling for the amortization of goodwill and other intangible assets is 20 years have been removed in PAS 38. Accordingly, an entity may use a useful life of more than 20 years to amortize its intangible assets. In addition, intangible assets may be assessed as having indefinite useful lives and therefore should not be amortized but should be subjected to annual impairment testing.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and install the specific software. Costs associated with maintaining computer software are expensed as incurred.

PAS 1.108 (b)

Costs associated with research activities are expensed in the statement of income as they occur. Costs that are directly attributable to the development phase of new customized software for IT and telecommunications systems are recognized as intangible assets provided they meet the following recognition requirements:

a. demonstration of technical feasibility of the prospective product for internal use or sale;

b. the intangible asset will generate probable economic benefits through internal use or sale;

c. sufficient technical, financial and other resources are available for completion; and,

d. the intangible asset can be reliably measured.

PAS 38.118 (a) (c) (d)

Directly attributable costs include employee costs incurred on software development along with an appropriate portion of relevant overheads. The costs of internally generated software developments are recognized as intangible assets; they are subject to the same subsequent measurement method as externally acquired software licenses. However, until completion of the development project, the assets are subject to impairment testing only as described in Note 3.16. Amortization commences upon completion of the asset.

PAS 1.113

All other development costs are expensed as incurred.

Careful judgment by management is applied when deciding whether the recognition requirements for development costs have been met. This is necessary as the economic success of any product development is uncertain and may be subject to future technical problems at the time of recognition. Judgments are based on the information available at each balance sheet date. In addition, all internal activities related to the research and development of new software products are continuously monitored by management.

PAS 1.108 (b)

### *3.10 Assets Classified as Held-for-Sale*

Assets held-for-sale include intangible assets and property and equipment that the Company intends to sell within one year from the date of classification as held for sale.

Assets classified as held-for-sale are measured at the lower of their carrying amounts, immediately prior to their classification as held for sale and their fair value less costs to sell. Assets classified as held-for-sale are not subject to depreciation or amortization. The profit or loss arising from the sale or revaluation of held-for-sale assets is included in the Other Income (Charges) account in the statement of income.

### *3.11 Financial Liabilities*

PAS 1.108 (b)

Financial liabilities include bank loans, trade and other payables and finance lease liabilities.

PAS 32.60 (b)

Financial liabilities are recognized when the Company becomes a party to the contractual agreements of the instrument. All interest related charges are recognized as an expense in the statement of income under the caption Finance Costs.

PAS 32.60 (a) (b)
PAS 32.66 (c)

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

Finance lease liabilities are measured at initial value less the capital element of lease repayments (see Note 27).

PAS 32.60 (a) (b)

Trade payables are recognized initially at their nominal value and subsequently measured at amortized cost less settlement payments.

PAS 10.12

Dividend distributions to shareholders are recognized as financial liabilities when the dividends are approved by the shareholders.

PAS 39.39

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

PAS 1.108 (b)

### *3.12 Provisions*

PAS 1.108 (a)

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example, product warranties granted, legal disputes or onerous contracts.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the balance sheet date, including the risks and uncertainties associated with the present obligation. Any reimbursement expected to be received in the course of settlement of the present obligation is recognized, if virtually certain as a separate asset, not exceeding the amount of the related provision. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. In addition, long-term provisions are discounted to their present values, where time value of money is material.

PAS 1.108 (a)

Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the financial statements.

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

### *3.13 Revenue and Cost Recognition*

PAS 18.35 (a)

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

- Sale of goods – Revenue is recognized when the risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

- Rendering of services – Revenue from the installation of integrated circuits and other products is recognized by reference to the stage of completion. The stage of completion is measured by reference to the labor hours incurred to date as a percentage of total estimated labor hours for each contract. Where the outcome of the contract cannot be measured reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

- Interest – Revenue is recognized as the interest accrues (taking into account the effective yield on the asset).

- Dividends – Revenue is recognized when the stockholders' right to receive the payment is established.

Cost and expenses are recognized in the statement of income upon utilization of the service or at the date they are incurred. Expenditure for warranties is recognized and charged against the associated provision when the related revenue is recognized. Finance costs are reported on an accrual basis.

### *3.14 Leases*[28]

PAS 1.108 (a)
PAS 1.108 (b)

- Company as lessee – Leases, which transfer to the Company substantially all risks and benefits incidental to ownership of the leased item, are classified as finance leases and are recognized as assets and liabilities in the balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of 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 directly charged against income. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

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

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

  Leases, which do not transfer to the Company substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized as income in the statement of income on a straight-line basis over the lease term. Indirect costs incurred by the lessor in negotiating and arranging for an operating lease is added to the carrying amount of the leased asset and recognized as expense over the lease term.

### *3.15 Functional Currency and Foreign Currency Transactions*

PAS 21.53

- *Functional and Presentation Currency*

  Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Philippine pesos, which is the Company's functional currency.

[28] PAS 17.23, *Leases,* requires a general description of significant leasing arrangements including, but not limited to, (a) the basis on which contingent rent payments are determined; (b) the existence and terms of renewal or purchase options and escalation clauses and (c) restrictions imposed by the lease arrangements.

PAS 1.108 (a) (b)
PAS 21.23
PAS 21.28

- *Transaction and Balances*

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

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

### *3.16 Impairment of Non-financial Assets*[29]

PAS 1.108 (a)
PAS 1.108 (b)

The Company's intangible assets and property, plant and equipment are subject to impairment testing. Intangible assets with an indefinite useful life or those not yet available for use are tested for impairment at least annually. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

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

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

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

[29] Revise accounting policy disclosure for impairment if there is any goodwill.

PAS 1.108 (b)

### 3.17 Employee Benefits[30]

- *Retirement Benefit Obligations*

Pension benefits are provided to employees through a defined benefit plan, as well as several defined contribution plans.

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

PAS 19.79
PAS 19.80

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

PAS 19.120 (a)

Actuarial gains and losses are not recognized as an expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to profit or loss over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately. Past-service costs are recognized immediately in the statement of income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

PAS 19.44

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

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[30] If the entity does not have any of the employee benefit plans discussed in this note, do not include them in the disclosure. On the other hand, if there are share-based compensation and other post-employment obligations, disclose also the entity's policies here.

- *Termination Benefits*

PAS 19.134
PAS 19.139

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

- *Profit-sharing and Bonus Plans*

PAS 19.33

The Company recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Company recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation.

- *Compensated Absences*

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

### *3.18 Borrowing Costs*

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

### *3.19 Income Taxes*[31]

PAS 1.108 (a)
IAS 1.108 (b)

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

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

Under the balance sheet liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred income tax asset to be utilized.

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

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

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

### *3.20 Equity*

PAS 1.76 (b)

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

Additional paid-in capital includes any premiums received on the initial issuing of capital stock. Any transaction costs associated with the issuing of shares are deducted from additional paid-in capital, net of any related income tax benefits.

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

The revaluation reserve comprises gains and losses due to the revaluation of property, plant and equipment and certain financial assets.

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

[31] PAS 12, *Income Taxes,* provides the disclosure requirements for accounting for income taxes.

## 4. CASH AND CASH EQUIVALENTS

PAS 7.45

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

PAS 32.94 (g)(i)

| | | 2005 | | 2004 |
|---|---|---|---|---|
| Cash on hand and in banks | **P** | **2,885,116** | P | 3,445,563 |
| Short-term placements | | **13,757,132** | | 17,566,539 |
| | **P** | **16,642,248** | P | 21,012,102 |

PAS 32.60
PAS 32.67

Cash accounts with the banks generally earn interest at rates based on daily bank deposit rates. Short-term placements are made for varying periods of between 15 to 30 days and earn effective interest ranging from 4.5% to 7.1% in 2005 and 4.2% to 6.5% in 2004.

PAS 7.48
PAS 10.19

The balances of the cash on hand and in banks as of December 31, 2005 and 2004 did not include an amount of about P2.5 million which is shown as part of the non-current Trade and Other Receivables account (see Note 5). Such amount is not available for the general use of the Company in accordance with a restriction under a loan covenant (see Note 15).

## 5. TRADE AND OTHER RECEIVABLES

This account is composed of the following:

PAS 32.94 (i)

| | Notes | | 2005 | | 2004 |
|---|---|---|---|---|---|
| Current: | | | | | |
| Trade receivables | 24 | **P** | **20,696,078** | P | 19,251,912 |
| Allowance for impairment | | | **(4,892,010)** | | (4,385,726) |
| | | | **15,804,068** | | 14,866,186 |
| Due from related parties | 24 | | **6,080,000** | | 1,945,985 |
| Loans to employees | | | **2,905,008** | | 3,935,322 |
| Receivable under finance lease | 24, 27 | | **756,901** | | 943,333 |
| Others | | | **108,000** | | 108,000 |
| | | **P** | **25,653,977** | P | 21,789,826 |
| Non-current: | | | | | |
| Loans to employees | | **P** | **9,070,636** | P | 10,552,881 |
| Security deposit | | | **8,552,568** | | 7,437,015 |
| Receivable under finance lease | 24, 27 | | **3,740,090** | | 4,716,667 |
| Others | 4 | | **2,527,489** | | 2,527,489 |
| | | | **23,890,783** | | 25,234,052 |
| Allowance for impairment | | | **(2,000,000)** | | (2,000,000) |
| | | **P** | **21,890,783** | P | 23,234,052 |

A reconciliation of the allowance for impairment at beginning and end of 2004[32] is shown below:

| | | **2005** | | 2004 |
|---|---|---|---|---|
| Current: | | | | |
| Balance at beginning of year | **P** | **4,385,726** | P | 2,449,284 |
| Impairment loss during the year | | **2,006,284** | | 1,936,442 |
| Write-off of receivables | **(** | **1,500,000)** | | - |
| Balance at end of year | **P** | **4,892,010** | P | 4,385,726 |
| Non-current: | | | | |
| Balance at beginning of year | **P** | **2,000,000** | P | 1,700,000 |
| Impairment loss during the year | | **-** | | 300,000 |
| Balance at end of year | **P** | **2,000,000** | P | 2,000,000 |

PAS 32.60 (a)
PAS 32.67
PAS 32.76 (b)
PAS 32.85

Trade receivables are usually due within 30-45 days and do not bear any interest. All trade receivables are subject to credit risk exposure. However, the Company does not identify specific concentrations of credit risk with regards to trade and other receivables, as the amounts recognized resemble a large number of receivables from various customers.

PAS 32.60 (a)
PAS 32.67

The loans to employees are interest bearing and payable through salary deduction within three years from the grant date. The effective interest rate on loans to employees is 6.5% in 2005 and 2004.

PAS 32.86
PAS 32.88

The fair value of these short-term financial assets is not individually determined as the carrying amount is a reasonable approximation of fair value.

Security deposit represents the P20 million deposit for the lease of the Company's warehouses from a third party, refundable at the end of the lease term in February 2012. The security deposit is remeasured at amortized cost using the effective interest rate of 15.0% at the inception of the lease contract in February 2002. Interest income recognized in 2005 and 2004 is presented under the Other Operating Income account in the statements of income (see Note 19). The fair values of the security deposit in 2005 and 2004 amounted to P9,668,120 and P8,470,060, respectively. These are determined by calculating the present value of the cash flows anticipated until the end of the lease term using interest rates of 12.7% in 2005 and 13.5% in 2004. As the deposit does not have active market, the underlying interest rates were determined by reference to market interest rate of comparable financial instrument.

[32] SEC Rule 68.1 requires a disclosure of the allowance for doubtful accounts and reversal of allowance for doubtful accounts during the period.

## 6. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This account consists of the following financial assets:

| | | **2005** | | 2004 |
|---|---|---|---|---|
| Listed equity securities in: | | | | |
| Philippines | **P** | **16,105,455** | P | 21,754,837 |
| Hong Kong | | **9,663,273** | | 16,920,429 |
| Unites States | | **6,442,182** | | 9,668,816 |
| | **P** | **32,210,910** | P | 48,344,082 |

PAS 32.94 (a)

The carrying amounts of the above financial assets are classified as follows:

| | | **2005** | | 2004 |
|---|---|---|---|---|
| Held-for-trading | **P** | **16,105,455** | P | 21,754,837 |
| Designated as at fair value through profit or loss on initial recognition | | **16,105,455** | | 26,589,245 |
| | **P** | **32,210,910** | P | 48,344,082 |

PAS 32.92 (a)(b)

All amounts presented have been determined directly by reference to published price quoted in an active market.

PAS 32.94 (c)

The Company recognized the increase in value of financial asset designated as at fair value through profit or loss of P757,000 in 2005 and decrease in fair value of P1,210,000 in 2004, which were included in the line item Other Operating Income in the statements of income (see Note 19).

## 7. INVENTORIES

PAS S 1.74

Except for the portion of finished goods stated at net realizable value, inventories at the end of 2005 and 2004 were stated at cost.[33] The details of inventories are shown below:

PAS 2.36 (b)

PAS 2.36 (c)

| | | **2005** | | 2004 |
|---|---|---|---|---|
| Finished goods: | | | | |
| At cost | **P** | **13,761,853** | P | 17,667,984 |
| At net realizable value | | **12,432,280** | | 15,469,089 |
| | | **26,194,133** | | 33,137,073 |
| Work in progress | | **21,456,010** | | 24,456,155 |
| Raw materials | | **3,300,505** | | 2,100,029 |
| Materials in transit | | **500,200** | | 457,059 |
| | **P** | **51,450,848** | P | 60,150,316 |

[33] It was assumed in this presentation that the rest of the inventory items are stated as cost. If all or more than one of the inventory items consist of items that are stated at cost and at net realizable value (NRV), present separate rows of items at cost and at NRV. Disclosure should also include reversal of write-down that is recognized as income in the period, if any, and the circumstances or events that led to the reversal of a write-down of inventories.

PAS 2.36 (e)
PAS 2.36 (f)
PAS 2.36 (g)

In 2005, the Company reversed P2,821,209 inventory write-down following the sale of finished goods previously covered by the write-downs in 2003. In 2004, the inventory write-down amounted to P2,232,200. No reversal of previous write-downs was recognized in 2004. The inventory write-down and reversal are included in the Cost of Sales account in the statements of income.

PAS 2.36 (h)

Raw materials amounting to P3,215,400 and P1,750,890 in 2005 and 2004, respectively, have been released under trust receipt agreements (see Note 15.

PAS 1.116 (a)

In determining net selling prices of inventories, management takes into account the most reliable evidence available at the times the estimates are made. The Company's core business is continuously subject to rapid technology changes which may cause inventory obsolescence. Moreover, future realization of the carrying amounts of inventories is affected by price changes in different market segments of computer hardware components. Both aspects are considered key sources of estimation uncertainty and may cause significant adjustments to the Company's inventories within the next financial year.

## 8. PREPAYMENTS

The composition of this account as of December 31 is shown below:

| | **2005** | 2004 |
|---|---|---|
| Prepaid rent | **P 6,358,031** | P 6,015,190 |
| Prepaid insurance | **3,789,000** | 2,400,125 |
| Input value-added tax | **2,000,138** | 1,440,283 |
| Others | **2,511,969** | 1,305,217 |
| | **P 14,659,138** | P 11,160,815 |

## 9. NON-CURRENT FINANCIAL ASSETS

PAS 1.74

The amounts in the balance sheet comprise of the following categories of financial assets:

| | **2005** | 2004 |
|---|---|---|
| Held-to-maturity financial assets: | | |
| Government bonds | **P 15,000,000** | P 15,000,000 |
| Corporate bonds | **5,360,400** | 5,618,300 |
| | **20,360,400** | 20,618,300 |
| Allowance for impairment | **( 1,350,453)** | - |
| | **19,009,947** | 20,618,300 |
| Available-for-sale financial assets: | | |
| Equity securities | **7,562,354** | 5,562,845 |
| Convertible corporate bonds | **3,850,400** | 4,250,210 |
| Golf club shares | **3,000,000** | 4,500,000 |
| | **14,412,754** | 14,313,055 |
| | **P 33,422,701** | P 34,931,355 |

PAS 32.92 (b)
PAS 32.86

Interest income recognized in 2005 and 2004 are presented under Other Income (Charges) account in the statements of income (see Note 21).

PAS 32.67 (a) (b)

### *9.1 Held-to-Maturity Investments*

Government bonds consist of ten-year peso-denominated bonds issued by the Philippine government which bear fixed interest rate of 13.75% per annum and will mature on September 30, 2012.

PAS 32.67 (a) (b)

Corporate bonds are five-year U.S. dollar-denominated bonds issued by a third party which bear fixed interest rate of 6.25% per annum and will mature on October 31, 2007. The Company's management noted that there is a measurable decrease on the estimated cash flows from these bonds due to the decline in the credit rating of the issuer. Accordingly, an impairment loss of P1,350,453 was recognized in 2005, presented as part of Other Income (Charges) in the statements of income (see Note 21).

PAS 32.86

The fair values of the held-to-maturity financial assets are as follows:

| | **2005** | 2004 |
|---|---|---|
| Government bonds | **P 15,945,382** | P 15,346,432 |
| Corporate bonds | **4,009,947** | 5,232,376 |
| | **P 19,955,329** | P 20,578,808 |

The fair values of these bonds are based on the published price quotations in active markets.

### *9.2 Available-for Sale Financial Assets*

The reconciliation of the carrying amounts of available-for-sale financial assets are as follows:

| | **2005** | 2004 |
|---|---|---|
| Balance at the beginning of year | **P 14,313,055** | P 14,505,938 |
| Transfer of change in fair value to profit or loss | **2,050,154** | - |
| Additions | **1,200,645** | - |
| Impairment losses | **( 3,500,000)** | - |
| Fair value gains | **478,297** | ( 142,523) |
| Foreign currency losses | **( 129,243)** | ( 50,360) |
| | **P 14,412,754** | P 14,313,055 |

PAS 32.67 (a) (b)

Equity securities mainly consist of investment in companies listed in the Philippine Stock Exchange.

PAS 32.67 (a) (b)

Convertible corporate bonds are U.S dollar-denominated bonds subject to floating interest rate which will mature on May 1, 2009. The effective interest rate in 2005 and 2004 is 5.4% and 6.1%, respectively. The conversion or repayment of the bonds is at the Company's discretion. Conversion ratios are yet to be determined by the issuer of the convertible bonds. Upon repayment, the Company is scheduled to receive US$90,000. The fair value of convertible bonds declined by P540,000 in 2005 and P320,567 in 2004. These losses were not considered permanent, therefore, were not transferred from equity to profit or loss.

PAS 32.67 (a) (b)
PAS 32.63
PAS 32.94 (h)

Golf club shares are proprietary membership club shares. In 2005 and 2004 the fair value of these shares declined by P1,500,000 and P800,000 respectively. The Company's management has determined in 2005 that there is an objective evidence that the decline in the value of these shares is permanent. Accordingly, losses amounting to P3,550,154, representing losses in 2005 and prior years charged to equity, were recognized as impairment loss, charged to profit or loss for the current year. Impairment losses in 2005 and 2004 are presented as part of Other Income (Charges) account in the statements of income (see Note 21).

PAS 32.86

The fair values of available-for-sale financial assets have been determined directly by reference to published prices in active market.

## 10. INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES[34]

The components of the carrying values of investments in subsidiaries and associates accounted for under the cost method are as follows:

PAS 27.41 (d)

| | % Interest Held | 2005 | 2004 |
|---|---|---|---|
| Subsidiaries: | | | |
| D Company | 100% | **P 88,299,200** | P 88,299,200 |
| S Company | 80% | **47,993,960** | 47,993,960 |
| Associates: | | | |
| TXT Co. | 40% | **20,354,376** | 20,354,376 |
| KOL, Inc. | 30% | **16,875,750** | 11,250,500 |
| | | **173,523,286** | 167,898,036 |
| Allowance for impairment | | **( 18,950,900)** | ( 15,650,400) |
| | | **P 154,572,386** | P 152,247,636 |

The Company's subsidiaries and associates are all incorporated in the Philippines.

PAS 27.41 (d)

In June 2005, the Company made an additional investment in shares of KOL, Inc. amounting to P5 million which increased the Company's ownership interest in the investee from 20% to 30%.

PAS 39.66

[34] See Appendix for sample disclosure if not a separate FS (i.e., consolidated or investor's financial statements).

The Company's management has assessed that the investment in TXT Co. may not be recovered due to the downturn in the business prospects of this associate. Accordingly, an impairment loss was recognize based on the present value of the estimated cash flows discounted at the current market rate of return for similar financial asset. Impairment loss charged to profit or loss amounted to P3,300,500 in 2005 and 4,500,400 in 2004. This is presented as part of Other Income (Charges) in the statements of income (see Note 21).

## 11. PROPERTY, PLANT AND EQUIPMENT

PAS 1.75(a)

A reconciliation[35] of the carrying amounts at the beginning and end of 2005 and 2004, and the gross carrying amounts and the accumulated depreciation of property, plant and equipment are shown below:

PAS 16.73 (e)

PAS 16.73 (d)

PAS 16.73 (e)

PAS 16.73 (d)

| | Machinery and Equipment | Building and Improvement | Office Furniture and Equipment | Transportation Equipment | Land | Construction in Progress | Total |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2005, net of accumulated depreciation and impairment | P 34,658,378 | P 19,813,274 | P 6,852,143 | P 8,763,499 | P 19,290,800 | P 10,915,320 | P 100,293,414 |
| Additions | 11,700,000 | 3,200,000 | 5,700,000 | 2,865,597 | - | 4,055,823 | 27,521,420 |
| Disposals | - | - | ( 1,450,100 ) | ( 1,430,960) | - | - | ( 2,881,060 ) |
| Depreciation charge for the year | ( 5,927,946) | ( 4,700,800 ) | ( 2,750,250 ) | ( 2,269,290) | - | - | ( 15,648,286 ) |
| Impairment loss | ( 1,200,000) | - | - | - | - | - | ( 1,200,000 ) |
| Balance at December 31, 2005, net of accumulated depreciation and impairment | **P 39,230,432** | **P 18,312,474** | **P 8,351,793** | **P 7,928,846** | **P 19,290,800** | **P 14,971,143** | **P 108,085,488** |
| December 31, 2005 | | | | | | | |
| Cost or valuation | P 87,090,471 | P 32,641,962 | P 25,533,503 | P 20,408,305 | P 19,290,800 | P 14,971,143 | P 199,936,184 |
| Accumulated depreciation | ( 43,460,039) | ( 14,329,488 ) | ( 17,181,710 ) | ( 12,479,459) | - | - | ( 87,450,696 ) |
| Accumulated impairment loss | ( 4,400,000) | - | - | - | - | - | ( 4,400,000 ) |
| Net carrying amount | **P 39,230,432** | **P 18,312,474** | **P 8,351,793** | **P 7,928,846** | **P 19,290,800** | **P 14,971,143** | **P 108,085,488** |
| Balance at January 1, 2004, net of accumulated depreciation and impairment | P 30,050,284 | P 16,343,004 | P 7,302,493 | P 10,103,159 | P 16,860,800 | P 8,859,460 | P 89,519,200 |
| Additions | 9,300,500 | 2,670,870 | 2,650,000 | 1,860,590 | - | 2,055,860 | 18,537,820 |
| Revaluations | - | 4,450,200 | - | - | 2,430,000 | - | 6,880,200 |
| Depreciation charge for the year | ( 3,572,406) | ( 3,650,800 ) | ( 3,100,350 ) | ( 3,200,250) | - | - | ( 13,523,806 ) |
| Impairment loss | ( 1,120,000) | - | - | - | - | - | ( 1,120,000 ) |
| Balance at December 31, 2004, net of accumulated depreciation and impairment | P 34,658,378 | P 19,813,274 | P 6,852,143 | P 8,763,499 | P 19,290,800 | P 10,915,320 | P 100,293,414 |
| December 31, 2004 | | | | | | | |
| Cost or valuation | P 75,390,471 | P 29,441,962 | P 19,833,503 | P 17,542,708 | P 19,290,800 | P 10,915,320 | P 172,414764 |
| Accumulated depreciation | ( 37,532,093) | ( 9,628,688 ) | ( 12,981,360 ) | ( 8,779,209) | - | - | ( 68,921,350 ) |
| Accumulated impairment loss | ( 3,200,000) | - | - | - | - | - | ( 3,200,000 ) |
| Net carrying amount | P 34,658,378 | P 19,813,274 | P 6,852,143 | P 8,763,499 | P 19,290,800 | P 10,915,320 | P 100,293,414 |

[35] PAS 16 requires the disclosure, for each class of property, plant and equipment, of a reconciliation showing the gross carrying amounts and accumulated depreciation (and impairment, if any) of property, plant and equipment at the beginning and at the end of the year and the changes during the year.

PAS 16.77 (a-d)

The Company's land and building and improvements were last revalued on December 15, 2004 by independent appraisers. Fair value is determined by reference to market-based evidence, which is the amount for which the assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction as at the valuation date. The revaluation surplus net of applicable deferred income taxes was credited to the Revaluation Reserves account in the equity section of the balance sheets.

PAS 16.77 (e)

If land and building and improvements were measured at cost model, the carrying amounts would be as follows:[36]

| | Building and Improvements | | Land | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Cost | **P 22,691,462** | P 19,491,462 | **P 13,660,800** | P 13,660,800 |
| Accumulated depreciation | **( 9,757,822)** | ( 6,242,795 ) | **-** | - |
| Net carrying amount | **P 12,933,640** | P 13,248,677 | **P 13,660,800** | P 13,660,800 |

PAS 16.74 (b)

Construction in progress in prior years pertains to accumulated costs incurred on the new building being constructed as part of the Company's expansion program, including borrowing costs capitalized during the period of about P0.8 million in 2005 and P3.8 million in 2004, representing the actual borrowing costs incurred on loans obtained to fund the construction project.

PAS 36.126 (a)
PAS 36.126 (b)

In 2005 and 2004, the Company recognized impairment losses of P1.2 million and P1.1 million, respectively, to write-down to recoverable amount certain assets following the reorganization within the electronics segment. The recoverable amount was based on value in use and was determined at the cash-generating unit level. In determining the value in use for the cash-generating unit, the cash flows were discounted at a nominal rate of 12.1% in 2005 and 2004 on a pre-tax basis. Impairment loss is charged to the Cost of Sales account in the statements of income.

The amount of depreciation and amortization is allocated as follows:

| | **2005** | 2004 |
|---|---|---|
| Cost of sales | **P 9,985,496** | P 9,017,385 |
| Cost of services | **452,575** | 305,120 |
| Selling and distribution costs | **3,126,129** | 2,520,781 |
| Administrative expenses | **2,084,086** | 1,680,520 |
| | **P 15,648,286** | P 13,523,806 |

[36] Present this analysis only for PPE items stated at revalued amount (fair value).

[37] PAS 17 requires, among others, the disclosure of the net carrying amount for each class of asset under a finance lease as at the balance sheet date.

PAS 16.74 (a)

Land and building and improvements with a total carrying value of about P20 million are used as collaterals for certain interest-bearing loans and borrowings (see Note 14).

PAS 17.35 (c )

As of December 31, 2005 and 2004, the carrying amount of transportation equipment held under finance leases amounted to P1.4 million and P1.6 million, respectively (see Note 27).[37]

## 12. INVESTMENT PROPERTY

PAS 40.75 (f)

The Company's investment property includes several pieces of land which are owned for investment purposes only. No income or loss (other than fair value gains) [38]or direct operating expenses were recognized during the reporting periods presented. Real estate tax amounting to P185,000 for each year was recognized as a related expense in 2005 and 2004.

PAS 40.76 (b)

The changes to the carrying amounts presented in the balance sheet as of December 31, 2005 can be summarized as follows:

| | **2005** | 2004 |
|---|---|---|
| Balance at beginning of year | **P 16,756,936** | P 15,436,500 |
| Additions | **1,019,316** | - |
| Fair value gains (see Note 21) | **1,740,342** | 1,320,436 |
| Balance at end of year | **P 19,516,594** | P 16,756,936 |

PAS 40.76 (d) (e)

Investment property is valued annually at the end of the year at fair value, comprising market value determined by independent appraisers.

## 13. INTANGIBLE ASSETS

A reconciliation of the carrying amounts at the beginning and end of 2005 and the gross carrying amounts and the accumulated amortization of intangible assets are shown below:

PAS 38.118 (e)

| | **Licenses and Franchises** | **Deferred Development Costs** | **Total** |
|---|---|---|---|
| Balance at January 1, 2005, net of accumulated amortization | P 1,300,000 | P 750,000 | P 2,050,000 |
| Additions | 5,280,000 | 5,400,000 | 10,680,000 |
| Amortization expense for the year | ( 1,628,000) | ( 900,000) | ( 2,528,000) |
| Balance at December 31, 2005, net of accumulated amortization | **P 4,952,000** | **P 5,250,000** | **P 10,202,000** |

[38] Disclose amount of income earned from investment property, if there's any.

PAS 38.118 (c)

| | Licenses and Franchises | Deferred Development Costs | Total |
|---|---|---|---|
| December 31, 2005: | | | |
| Cost | P 13,780,000 | P 9,150,000 | P 22,930,000 |
| Accumulated amortization | ( 8,828,000) | ( 3,900,000) | ( 12,728,000) |
| Net carrying amount | **P 4,952,000** | **P 5,250,000** | **P 10,202,000** |
| Balance at January 1, 2004, net of | | | |
| Accumulated amortization | P 2,400,000 | P 1,500,000 | P 3,900,000 |
| Amortization expense for the year | ( 1,100,000) | ( 750,000) | ( 1,850,000) |
| Balance at December 31, 2004, net of accumulated amortization | P 1,300,000 | P 750,000 | P 2,050,000 |
| December 31, 2004: | | | |
| Cost | P 8,500,000 | P 3,750,000 | P 12,250,000 |
| Accumulated amortization | ( 7,200,000) | ( 3,000,000) | ( 10,200,000) |
| Net carrying amount | P 1,300,000 | P 750,000 | P 2,050,000 |

PAS 38.118 (e)

PAS 38.118 (c)

In addition to development costs capitalized, the Company expensed P563,000 and P540,000 in 2005 and 2004, respectively, research and development costs incurred during those years.

PAS 38.126

During the year, the Company also entered into a purchase agreement to update its business process software used by the Company for administration and control. Minimum contractual commitments resulting from this agreement are P4,220,000, payable in 2006. No contractual commitments were entered into during 2004.

PAS 38.122 (e)

Intangible assets are subject to annual impairment testing and whenever there is an indication of impairment. No impairment losses were recognized in 2005 and 2004 as the carrying values of the intangible assets are lower than their recoverable amounts.

The amount of amortization charge were allocated as follows:

PAS36.130

| | **2005** | 2004 |
|---|---|---|
| Selling and distribution costs | **P 1,516,800** | P 1,110,000 |
| Administrative expenses | **1,011,200** | 740,000 |
| | **P 2,528,000** | P 1,850,000 |

PAS 38.118 (d)
PAS 36.126 (a) (b)

## 14. ASSETS HELD-FOR-SALE

PFRS 5.41

Assets held for sale consist of items of property and equipment of a business unit that the Company has discontinued. The Company expects to sell these assets in 2006.

## 15. INTEREST-BEARING LOANS AND BORROWINGS[39]

At December 31, the short-term and long-term interest-bearing loans and borrowings were as follows:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Current: | | | |
| Bank loans | | **P 10,000,000** | P 10,000,000 |
| Acceptances payable and liabilities under trust receipts | 7 | **3,000,000** | 4,000,000 |
| Obligations under finance leases | 27 | **180,000** | 180,000 |
| Others | | **1,110,100** | 2,472,700 |
| | | **P 14,290,000** | P 16,652,700 |
| Non-current: | | | |
| Bank loans | 4 | **P 53,600,000** | P 56,300,000 |
| Obligations under finance leases | 27 | **1,220,000** | 1,400,000 |
| | | **P 54,820,000** | P 57,700,000 |

PAS 32.60 (a)
PAS 32 67 (a)

The bank loans represent secured and unsecured loans from a local commercial bank. The loans bear annual interest rates ranging from 10.75% to 16.5% in both years, subject to monthly repricing.

PAS 32.86

The long-term debt represents the US$760,000 loan obtained by the Company in December 2002 from a local bank. The debt is payable up to 2007 and bears interest at an annual average rate of 9% in 2005 and 8% in 2004. On December 29, 2003, the Company obtained an additional loan from the same bank amounting to US$240 million. The new loan, which is payable up to 2010, bears interest at 10% per annum.

The finance lease liability has an effective interest rate of 8.75%, which is equal to the rate implicit in the lease. Lease payments are made on a monthly basis (see Note 27).

[39] Separately disclose/indicate if interest-bearing loans and borrowings include items denominated in foreign currency.

PAS 32.92 (a)
PAS 32.92 (b)

The fair values of the long-term[40] financial liabilities are as follows:

| | | 2005 | | 2004 |
|---|---|---|---|---|
| Bank loans | **P** | **56,420,540** | P | 56,120,031 |
| Obligations under finance leases | | **1,110,100** | | 1,382,700 |
| | **P** | **57,530,640** | P | 57,502,731 |

The fair values of long-term financial liabilities have been determined by calculating their present values at the balance sheet date, using fixed effective market interest rates available to the Company. No fair value changes have been included in profit or loss for the period as financial liabilities are carried at amortized cost in the balance sheet.

Certain Company assets and property are used as collaterals for the secured short-term bank loans and the long-term debt (see Notes 4, 7 and 11).

## 16. TRADE AND OTHER PAYABLES

This account consists of:

PAS 1.60

| | | 2005 | | 2004 |
|---|---|---|---|---|
| Trade payables (see Note 24) | **P** | **38,657,586** | P | 40,661,477 |
| Accrued expenses | | **9,242,886** | | 15,542,050 |
| Others | | **1,187,541** | | 5,245,098 |
| | **P** | **49,088,013** | P | 61,448,625 |

PAS 32.88

Accrued expenses include the current portion of the Company's obligations to its current and former employees that are expected to be settled within 12 months from the balance sheet date. These liabilities arise mainly from accrued holiday entitlement at the balance sheet date and pension payments. As none of the employees is eligible for early settlement of pension arrangements, the remaining part of pension obligations is considered non-current (see Note 22).

The fair values of trade and other payables have not been disclosed as, due to their short duration, management considers the carrying amounts recognized in the balance sheets to be a reasonable approximation of their fair values.

[40] The fair value of short-term financial liabilities need not be determined individually as the carrying amount is a reasonable approximation of the fair values.

PAS 1.75 (d)

## 17. PROVISIONS

The changes in each class of provisions during the year are as follows[41]:

PAS 37.84

| | Product Warranty | Leased Property Restoration | Total |
|---|---|---|---|
| Balance at January 1, 2005 | P 11,105,649 | P 3,613,015 | P 14,718,664 |
| Additional provisions | 6,730,500 | 469,692 | 7,200,192 |
| Amounts used | ( 9,057,252) | - | ( 9,057,252) |
| Unused amount reversed | ( 1,750,654) | - | ( 1,750,654) |
| Balance at December 31, 2005 | **P 6,428,243** | **P 4,082,707** | **P 10,510,950** |
| Balance at January 1, 2004 | P 13,438,511 | P 3,197,359 | P 16,635,870 |
| Additional provisions | 4,379,620 | 415,656 | 4,795,276 |
| Amounts used | ( 5,456,030) | - | ( 5,456,030) |
| Unused amount reversed | ( 1,256,452) | - | ( 1,256,452) |
| Balance at December 31, 2004 | P 11,105,649 | P 3,613,015 | P 14,718,664 |

| | Product Warranty | Leased Property Restoration | Total |
|---|---|---|---|
| December 31, 2005 | | | |
| Current | P 4,829,437 | P - | P 4,829,437 |
| Non-current | 1,598,806 | 4,082,707 | 5,681,513 |
| | **P 6,428,243** | **P 4,082,707** | **P 10,510,950** |
| December 31, 2004 | | | |
| Current | P 8,511,981 | P - | P 8,511,981 |
| Non-current | 2,593,668 | 3,613,015 | 6,206,683 |
| | P 11,105,649 | P 3,613,015 | P 14,718,664 |

### *17.1 Product warranty*

A provision is recognized for expected warranty claims on products sold during the last three years, based on the Company's past experience of the level of repairs and returns. It is expected that a significant portion of the provision will be incurred in 2006.

### *17.2 Leased property restoration*

The Company leases warehouses from a third party. The lease agreement requires the Company to restore the warehouse to its original state at the end of the lease term in 2012. A provision was recognized for the present value of the costs to be incurred for the restoration of the leased warehouses. The total estimated cost to be incurred at the end of lease term amounted to P8.5 million.

[41] PAS 37 requires disclosure, for each class of provisions, of the carrying amount at the beginning and end of year and the changes during the year.

## 18. COST OF GOODS SOLD AND COST OF SERVICES[42]

### *18.1 Cost of Goods Sold*

The details of this account are shown below:

| | 2005 | 2004 |
|---|---|---|
| Finished goods at beginning of year | **P 44,167,996** | P 40,079,614 |
| Cost of goods manufactured | | |
| Raw materials at beginning year | **2,100,029** | 4,559,225 |
| Work-in-process at beginning year | **24,456,155** | 27,686,672 |
| Net purchases during the year | **34,543,161** | 25,051,000 |
| Direct labor | **34,385,100** | 20,438,854 |
| Manufacturing overhead | **19,618,714** | 21,240,760 |
| Raw materials at end of year | **( 3,300,505)** | ( 2,100,029) |
| Work-in-process at end of year | **( 21,456,010)** | ( 24,456,155) |
| | **90,337,644** | 69,577,665 |
| Finished goods at end of year | **( 34,404,633)** | ( 44,167,996) |
| | **P 100,110,007** | P 68,331,945 |

### *18.2 Cost of Services*

The following are the breakdown of direct costs and expenses from rendering of services:

| | 2005 | 2004 |
|---|---|---|
| Salaries, wages and benefits | **P 6,952,007** | P 6,512,500 |
| Materials, supplies and facilities | **1,771,025** | 1,447,125 |
| Outside services | **800,100** | 754,125 |
| Depreciation | **452,575** | 305,120 |
| Rental | **200,378** | 180,120 |
| Others | **54,269** | 75,725 |
| | **P 10,230,354** | P 9,274,715 |

## 19. OTHER OPERATING INCOME AND EXPENSES

Presented below are the details of these accounts:

### *19.1 Other Operating Expenses*

PAS 32.94 (h) (i)

| | 2005 | 2004 |
|---|---|---|
| Impairment losses on trade and receivables (see Note 5) | **P 2,006,284** | P 2,236,442 |
| Others | **599,071** | 622,304 |
| | **P 2,605,355** | P 2,858,746 |

[42] BIR requires disclosure of the breakdown of cost of sales and services in the notes to FS.

### *19.2 Other Operating Income*

PAS 21.52 (a)

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Fair value gains – financial assets at fair value through profit or loss | 6 | **P 2,412,922** | P 2,562,874 |
| Interest income from short-term placements | 4 | **1,219,920** | 469,995 |
| Security deposits | 5 | **1,115,552** | 970,045 |
| Foreign currency gains – net | | **654,246** | 157,195 |
| Interest income from cash in bank | 4 | **234,197** | 102,155 |
| | | **P 5,636,837** | P 4,262,264 |

## 20. OPERATING EXPENSES BY NATURE

The details of operating expenses by nature are shown below:

PAS 1.93

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Salaries and employee benefits | 22 | **P 56,868,438** | P 40,745,265 |
| Raw materials and other consumables | | **38,189,134** | 29,544,476 |
| Depreciation and amortization | 11, 23 | **18,176,286** | 15,373,806 |
| Changes in inventories of finished goods and work-in-process | | **9,943,085** | 6,001,702 |
| Outside services | | **8,369,481** | 4,486,712 |
| Management fees | 24 | **7,000,800** | 4,975,811 |
| Rentals | 24 | **3,771,709** | 3,335,610 |
| Impairment losses on trade and other receivables | 5 | **2,006,284** | 2,236,442 |
| Taxes and licenses | | **1,990,780** | 1,956,788 |
| Communications | | **1,709,151** | 1,609,154 |
| Impairment losses on property, plant and equipment | 11 | **1,200,000** | 1,120,000 |
| Transportation and travel | | **804,142** | 1,554,976 |
| Others | | **1,832,844** | 1,436,932 |
| | | **P 151,862,134** | P 114,377,674 |

These expenses are classified in the statements of income as follows:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Cost of sales | 18 | **P 100,110,007** | P 68,331,945 |
| Cost of services | 18 | **10,230,354** | 9,274,715 |
| Selling and distribution costs | | **23,829,851** | 20,545,136 |
| Administrative expenses | | **15,086,567** | 13,367,132 |
| Other operating expenses | | **2,605,355** | 2,858,746 |
| | | **P 151,862,134** | P 114,377,674 |

## 21. OTHER INCOME (CHARGES)

### *21.1 Finance Costs*

The breakdown of this account is as follows:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Interest expense resulting from: | | | |
| Bank loans and borrowings | 15 | **P 10,204,530** | 10,057,718 |
| Provisions | 17 | **469,692** | 415,657 |
| Liabilities under a finance lease | 15 | **435,908** | 456,155 |
| | | **P 11,110,130** | P 10,929,530 |

### *21.2 Other Gains (Losses)*

The Other Gains (Losses) - net account consists of the following:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Other Losses: | | | |
| Impairment losses on: | | | |
| Available-for-sale financial assets | 9 | **(P 3,500,000)** | P - |
| Investments in associates | 10 | **( 3,300,500)** | ( 4,500,400) |
| Held-to-maturity investments | 9 | **( 1,350,453)** | - |
| | | **( 8,150,953)** | ( 4,500,400) |
| Other Gains: | | | |
| Interest income resulting from: | | | |
| Held-to-maturity Investments | 9 | **2,315,325** | 2,454,768 |
| Available-for-sale financial assets | 9 | **652,879** | 548,231 |
| | | **2,968,204** | 3,002,999 |
| Fair value gains from investment property | 12 | **1,740,342** | 1,320,436 |
| Dividends | 10 | **1,450,000** | 1,450,000 |
| Foreign currency gains | | **254,863** | 105,876 |
| Others | | **206,284** | - |
| | | **6,619,693** | 5,879,311 |
| | | **(P 1,531,260)** | P 1,378,911 |

## 22. EMPLOYEE BENEFITS

PAS 1.93

Expenses recognized for employee benefits (see Note 20) are presented below:

| | 2005 | 2004 |
|---|---|---|
| Salaries and wages | **P 43,033,484** | P 26,470,330 |
| Retirement – defined benefit plan | **6,766,105** | 9,767,702 |
| Social security costs | **2,623,874** | 1,647,873 |
| Compensated absences | **1,885,896** | 1,025,823 |
| Bonuses | **1,421,711** | 1,018,632 |
| Short-term medical benefits | **1,137,368** | 814,905 |
| | **P 56,868,438** | P 40,745,265 |

PAS 19.120 (b)

The Company maintains a tax-qualified, noncontributory retirement plan that is being administered by a trustee covering all regular full-time employees.

The Company obtained an updated actuarial valuation as of January 1, 2004 to ascertain its transitional liability as of that date in accordance with PAS 19, *Employee Benefits*. The Company's transition to PAS 19 is discussed in Note 2. Actuarial valuations are made every two years to update the retirement benefit costs and the amount of contributions.

PAS 19.120 (c)

The amounts of retirement benefit obligation recognized in the balance sheets (based on actuarial valuation report) are determined as follows:

| | 2005 | 2004 |
|---|---|---|
| Present value of the obligation | **P 69,554,491** | P 40,953,099 |
| Fair value of plan assets | **( 53,018,603)** | ( 43,956,344) |
| Deficiency (excess) of plan assets | **16,535,888** | ( 3,003,245) |
| Unrecognized actuarial gains | **71,125** | 19,498,318 |
| Retirement benefit obligation | **P 16,607,013** | P 16,495,073 |

PAS 19.120 (e)

The movements in the retirement benefit obligation recognized in the books are as follows:

| | 2005 | 2004 |
|---|---|---|
| Balance at beginning of year | **P 16,495,073** | P 16,486,077 |
| Expense recognized | **6,766,104** | 9,767,701 |
| Contributions paid | **( 6,654,1654)** | ( 9,758,705) |
| Balance at end of year | **P 16,607,013** | P 16,495,073 |

PAS 19.120 (f)

The amounts of retirement benefits recognized in the statements of income (based on actuarial valuation report) are as follows:

| | 2005 | 2004 |
|---|---|---|
| Current service costs | **P 5,885,962** | P 7,168,561 |
| Interest costs | **5,733,434** | 5,703,196 |
| Expected return on plan assets | **( 4,395,634)** | ( 3,104,055) |
| Net actuarial losses recognized during the year | **( 457,657)** | - |
| Retirement benefits | **P 6,766,105** | P 9,767,702 |

PAS 19.120 (f)

The amounts of retirement benefits is allocated as follows:

| | 2005 | 2004 |
|---|---|---|
| Cost of sales | **P 3,383,053** | P 4,883,852 |
| Cost of services | **1,353,221** | 1,953,540 |
| Operating expenses | **2,029,831** | 2,930,310 |
| Retirement benefits | **P 6,766,105** | P 9,767,702 |

PAS 19.120 (d)
PAS 19.120 (g)

The plan assets held for funding the defined benefit obligation include land occupied by an associate. They do not include any of the Company's own shares. Actual returns on plan assets were P2.41 million in 2005 and P3.16 million in 2004.

PAS 19.120 (h)

For determination of the retirement benefit obligation, the following actuarial assumptions were used:

| | 2005 | 2004 |
|---|---|---|
| Discount rates | **12%** | 14% |
| Expected rate of return on plan assets | **10%** | 10% |
| Expected rate of salary increases | **8%** | 8% |

## 23. TAXES

### *23.1 Current and Deferred Taxes*

The major components of tax expense for the years ended December 31 are as follows:

| | 2005 | 2004 |
|---|---|---|
| Statements of income: | | |
| Current tax expense: | | |
| Regular corporate income tax (at 35% and 32%) | **P 9,526,669** | P 17,756,653 |
| Final tax (at 20% and 7.5%) | **579,606** | 461,665 |
| | **10,106,275** | 18,218,318 |
| Deferred tax expense (income): | | |
| Deferred tax relating to origination and reversal of temporary differences | **4,452,646** | ( 1,899,536) |
| Deferred tax resulting from an increase in RCIT rate | **( 1,300,979)** | - |
| | **3,151,667** | ( 1,899,536) |
| Tax expense reported in statements of income | **P 13,257,942** | P 16,318,782 |
| Statement of changes in equity: | | |
| Deferred tax relating to origination and reversal of temporary differences | **(P 209,877)** | P 1,924,798 |
| Deferred tax resulting from an increase in RCIT rate | **434,311** | - |
| Tax expense reported in statements of changes in equity | **P 224,434** | P 1,924,798 |

The reconciliation of tax on pretax income computed at the applicable statutory rates to tax expense attributable to continuing operations is as follows:

| | **2005** | 2004 |
|---|---|---|
| Tax on pretax income (at 35% in 2005 and 32% in 2004) | **P 14,771,875** | P 16,208,375 |
| Adjustment for income subjected to lower income tax rates | **( 1,912,782)** | ( 682,382) |
| Tax effects of: | | |
| Increase in deductible temporary due to change in RCIT rate | **( 1,300,979)** | - |
| Non-taxable income | **( 1,618,004)** | ( 1,594,534) |
| Non-deductible interest expense | **705,993** | 567,748 |
| Impairment loss on investment in an associate | **2,226,463** | 1,440,128 |
| Non-deductible expenses | **385,376** | 379,447 |
| Tax expense reported in statements of income | **P 13,257,942** | P 16,318,782 |

PAS 12.81 (g)

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

| | Balance Sheets | | Statements of Income | | Statements of Equity | |
|---|---|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** | **2005** | **2004** |
| Deferred tax assets: | | | | | | |
| Retirement benefits | P 7,419,204 | P 7,294,652 | (P 124,553) | P 435,024 | P - | P - |
| Changes in provisions | 3,678,833 | 5,818,444 | 2,139,611 | ( 494,965) | - | - |
| Impairment losses on trade and other receivables | 2,412,204 | 2,043,432 | ( 368,771) | ( 715,661) | - | - |
| Impairment losses on long-term financial assets | 472,659 | - | ( 472,659) | - | - | - |
| Impairment losses on property, plant and equipment | 1,540,000 | 1,024,000 | ( 516,000) | ( 358,400) | - | - |
| Write-down of inventories to net realizable value | 781,270 | 1,617,091 | 835,821 | ( 714,304) | - | - |
| Deferred tax liabilities: | | | | | | |
| Revaluation reserve of property, plant and equipment | ( 3,853,092) | ( 3,902,274) | - | - | ( 49,183) | 1,822,217 |
| Changes in fair value of investment property | ( 1,946,272) | ( 1,222,540) | 648,733 | 422,540 | 75,000 | - |
| Undepreciated restoration costs of leased property | ( 525,840) | ( 560,896) | ( 35,056) | ( 80,128) | - | - |
| Unrealized foreign currency (gains) or losses | ( 328,158) | 716,382 | 1,044,540 | ( 393,640) | - | - |
| Changes in fair values of long-term financial assets | ( 301,198) | ( 102,581) | - | - | 198,617 | 102,581 |
| Deferred Tax Expense (Income) | | | **P 3,151,667** | **(P 1,899,536)** | **P 224,434** | **P 1,924,798** |
| Net Deferred Tax Assets | **P 9,349,608** | **P 12,725,709** | | | | |

The Company is subject to the minimum corporate income tax (MCIT) which is computed at 2% of gross income, as defined under the tax regulations. No MCIT was reported in 2005 and 2004 as the regular corporate income tax (RCIT) was higher than MCIT in both years.[43]

[43] If the entity has MCIT/NOLCO, present breakdown per layer (see AAR 2005-3 for details on presentation and disclosure in accordance with PAS 12).

### *23.2 New Tax Regulation*

On May 24, 2005, Republic Act No. 9337 ("RA 9337"), amending certain sections of the National Internal Revenue Code of 1997, was signed into law and become effective beginning November 1, 2005. The following are the major changes brought about by RA 9337 that are relevant to the Company:

a. RCIT rate is increased from 32% to 35% starting November 1, 2005 until December 31, 2008 and will be reduced to 30% beginning January 1, 2009;

b. 10% VAT rate remains unchanged, with the President of the Philippines having a stand-by authority effective January 1, 2006 to increase the VAT rate to 12% under certain conditions (the rate is increased to 12% effective February 1, 2006);

c. 10% VAT rate is now be imposed on certain goods and services that were previously zero-rated or subject to percentage tax;

d. Input tax on capital goods shall be claimed on a staggered basis over 60 months or the useful life of the related assets, whichever is shorter; and,

e. Creditable input VAT is capped by a maximum of 70% of output VAT per quarter.

## 24. RELATED PARTY TRANSACTIONS

The Company's related parties include its parent company, wholly owned subsidiaries, associates, the Company's key management and others as described below.

The following are the transactions with related parties[44]:

PAS 24.17, 22

### *23.1 Sales of Good and Services*

| | Amount of Transactions | | Outstanding Balances | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Sale of goods: | | | | |
| Subsidiaries | **P23,024,416** | P15,171,911 | **P 3,852,505** | P 5,291,293 |
| Associates | **9,524,623** | 5,698,125 | **1,235,841** | 500,365 |
| Rendering of services: | | | | |
| Subsidiaries – lease of equipment | **12,568,247** | 9,125,456 | **2,587,213** | 1,987,456 |
| Associate – administrative services | **3,251,789** | 2,548,698 | **923,546** | 523,874 |
| | **P48,369,075** | **P32,441,190** | **P 8,599,105** | **P 8,300,988** |

PAS 24.21

Goods are sold on the basis of the price lists in force with non-related parties. Services rendered are usually on a cost-plus basis, allowing a margin ranging from 20% to 30%.

The outstanding receivables from sales of goods and services are presented as Trade Receivables under the current Trade and Other Receivables account in the balance sheets (see Note 5).

[44] Management should disclose that related party transactions were made on an arms length basis only when such terms can be substantiates (PAS 24.21)

PAS 24.17

### *24.2 Purchases of Good and Services*

| | Amount of Transactions | | Outstanding Balances | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Purchases of goods: | | | | |
| Subsidiary | **P33,424,213** | P25,571,932 | **P 4,852,565** | P 2,291,243 |
| Associates | **7,514,223** | 6,993,126 | **235,841** | 1,543,334 |
| Purchases of services: | | | | |
| Parent - management services | **4,200,480** | 3,585,487 | **1,754,126** | 914,324 |
| Key management personnel services | **2,800,320** | 2,390,324 | **1,169,417** | 609,550 |
| | **P47,939,236** | **P38,540,869** | **P 8,011,949** | **P 5,358,451** |

PAS 24.21

Goods are bought on the basis of the price lists in force with non-related parties. The related outstanding payables for goods purchased in 2005 and 2004 are presented as Trade Payables under the Trade and Other Payable account in the balance sheets (see Note 16).

Services rendered are usually on a cost-plus basis, allowing a margin ranging from 20% to 30%. The related outstanding payables for services obtained in 2005 and
PAS 24.17
2004 are presented in the Due to Related Parties account in the balance sheets.

### *24.3 Advances from Related Parties*

The Company obtains advances from its parent company and its subsidiaries for working capital purposes. The advances are non-interest bearing and repayable within 12 months. The breakdown of advances are as follows:

| | **2005** | 2004 |
|---|---|---|
| Advances from parent company: | | |
| Balance at beginning of year | **P 12,495,316** | P 21,823,454 |
| Additions | **6,569,451** | 13,568,987 |
| Repayments | **( 13,897,456)** | ( 22,897,125) |
| Balance at end of year | **P 5,167,311** | P 12,495,316 |
| Advances from subsidiaries: | | |
| Balance at beginning of year | **P 13,869,677** | P 9,814,546 |
| Additions | **7,569,498** | 11,696,898 |
| Repayments | **( 15,178,660)** | ( 7,641,767) |
| Balance at end of year | **P 6,260,515** | P 13,869,677 |
| Total advances from related parties: | | |
| Balance at beginning of year | **P 26,364,993** | P 31,638,000 |
| Additions | **20,688,949** | 28,265,885 |
| Repayments | **( 29,076,116)** | ( 30,538,892) |
| Balance at end of year | **P 17,977,826** | P 29,364,993 |

[45] If the Company provides share-based payment compensations to employee, disclose relevant expenses for the periods presented.

PAS 24.16

### *24.4 Key Management Personnel Compensation*[45]

The key management personnel compensation includes the following expenses:

| | 2005 | 2004 |
|---|---|---|
| Short-term benefits | **P 10,365,041** | P 9,901,621 |
| Post-employment benefits | **3,861,758** | 2,451,029 |
| Termination benefits | **833,622** | 559,321 |
| Other long-term benefits | **781,759** | 451,029 |
| | **P 15,842,180** | P 13,363,000 |

PAS 24.17
PAS 37.86

### *24.5 Commitment and Contingencies*

The Company has guaranteed the loan obtained by its subsidiary from a local bank amounting to P28 million in 2005 and P35 million in 2004. The loan is repayable in 2006.

## 25. EQUITY

### *25.1 Capital Stock*

PAS 1.76 (a) (iii)
PAS 1.76 (a) (v)

Capital stock consists of:

PAS 1.76 (a) (iv)
PAS 1.76 (a) (ii)
PAS 1.76 (a) (i)

| | Shares | | Amount | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Preferred – 10% cumulative, non-participating , convertible into common shares – P100 par value | | | | |
| Authorized, issued and outstanding | **100,000** | 100,000 | **P 10,000,000** | P 10,000,000 |
| Common shares – P10 par value | | | | |
| Authorized – 35,000,000 shares | | | | |
| Issued: | | | | |
| Balance at beginning of year | **10,000,000** | 10,000,000 | **100,000,000** | 100,000,000 |
| Issued during the year | **4,000,000** | - | **40,000,000** | - |
| Balance at end of year | **14,000,000** | 10,000,000 | **140,000,000** | 100,000,000 |
| Subscribed: | | | | |
| Balance at beginning of year | **1,900,000** | 1,900,000 | **19,000,000** | 19,000,000 |
| Issued during the year | **( 1,900,000)** | - | **( 19,000,000)** | - |
| Balance at end of year | **-** | 1,900,000 | **-** | 19,000,000 |
| Subscriptions receivable: | | | | |
| Balance at beginning of year | | | **( 3,750,000)** | ( 3,750,000) |
| Collections during the year | | | **3,750,000** | - |
| Balance at end of year | | | **-** | ( 3,750,000) |
| | | | **P150,000,000** | P125,250,000 |

Each preferred share is convertible to ten common shares at the option of the Company.

As of December 31, 2005, the Company has 10 stockholders owning 100 or more shares each.[46]

### 25.2 Revaluation Reserves

The reconciliation of Revaluation Reserves is as follows:

| | Fair Value Reserves on Property, Plant and Equipment | Available-for-Sale | Related Deferred Tax | Total |
|---|---|---|---|---|
| Balance as of January 1, 2005 | P14,694,607 | (P 829,476) | (P 4,879,855) | P 8,985,276 |
| Fair value gains | - | 1,252,629 | ( 130,145) | 1,122,484 |
| Effects of change in RCIT rate | - | - | ( 434,311) | ( 434,311) |
| Depreciation transfer, building and improvements | ( 1,185,773) | - | 415,021 | ( 770,752) |
| Balance as of December 31, 2005 | P13,508,834 | P 423,153 | (P 5,029,290) | P 8,902,697 |
| | | | | |
| Balance as of January 1, 2004 | P 9,000,180 | (P 686,953) | (P 3,334,504) | P 4,978,723 |
| Fair value gains | 6,880,200 | ( 142,523) | ( 1,924,798) | 4,812,879 |
| Depreciation transfer, building and improvements | ( 1,185,773) | - | 379,447 | ( 806,326) |
| Balance as of December 31, 2004 | P14,694,607 | (P 829,476) | (P 4,879,855) | P 8,985,276 |

The fair value reserve on property, plant and equipment includes the fair value gain of a property reclassified to Investment Property under PFRS starting January 1, 2004 amounting to P2.5 million (see Note 2.6). The related deferred tax amounted to P875,000.

### 25.3 Retained Earnings

The Board of Directors approved the declaration of cash dividends of P1.57 per common share (or a total of P21,980,000) on June 30, 2005 and P1.14 per common share (or a total of P13,554,600) on June 30, 2004, payable to stockholders of record as of July 15, 2005 and 2004, respectively. The dividends were paid within their respective year of declaration and approval.

The aggregate amount of cumulative preferred dividends in arrears as of December 31, 2005 and 2004 amounted to P5 million and P4 million, respectively, or P5 per share and P4 per share, respectively.

[46] As a Firm policy, we should include this information in the note disclosure on capital stock of corporations filing under SRC Rule 68 as the Firm is required to issue a supplemental opinion on such information.

PAS 10.21

## 26. EVENTS AFTER THE BALANCE SHEET DATE[47]

On January 28, 2006, the Company's distribution warehouse was severely damaged by fire. Loss of inventory was limited, but there was and continues to be, a significant disruption in the flow of distribution. It is expected that insurance proceeds will fall short of costs of rebuilding and loss of inventories by about P1.2 million. The loss was taken up in 2005.

PAS 1.60
PAS 1.52

## 27. COMMITMENTS AND CONTINGENCIES[48]

The following are the significant commitments and contingencies involving the Company:

### *27.1 Operating Lease Commitments – Company as Lessee*

PAS 17.35 (a)
PAS 17.35 (d)

The Company is a lessee under non-cancellable operating leases covering certain warehouse and offices. The leases have terms ranging from four to ten years, with renewal options, and include annual escalation rates of 10%. The future minimum rentals payable under these non-cancellable operating leases as of December 31 are as follows:[49]

| | **2005** | 2004 |
|---|---|---|
| Within one year | **P 1,815,000** | P 1,815,000 |
| After one year but not more than five years | **4,362,171** | 6,177,171 |
| More than five years | **4,635,254** | 6,450,254 |
| | **P 10,812,425** | P 14,442,425 |

Total rentals from these operating leases amounted to P2.0 million in 2005 and 2004, of which the major portion was charged to Cost of Sales (see Note 18).

[47] PAS 10 requires that when non-adjusting events after the balance sheet date are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, an enterprise should disclose the following information for each significant category of non-adjusting event after the balance sheet date: (a) the nature of the event; and (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

[48] PAS 37, the disclosure for each class of contingent liability should include a brief description of the nature of the contingent liability and, where applicable: (a) an estimate of its financial effect; (b) an indication of the uncertainties relating to the amount or timing of any outflow; and (c) the possibility of reimbursement.

[49] PAS 17, *Leases*, requires the disclosure of information on future minimum rental payable for more than five years.

PAS 17.35 (c)
PAS 17.35 (b)

### *27.2 Finance Lease Commitments – Company as Lessee[50]*

The Company has finance leases covering certain transportation equipment with terms ranging from three to six years. The leases provide options to purchase the transportation equipment at the end of the lease terms. Future minimum lease payments (MLP) under the finance leases together with the present value (PV) of the net minimum lease payments (NMLP) are as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Future MLP | PV of NMLP | Future MLP | PV of NMLP |
| Within one year | **P 190,000** | **160,000** | P 210,000 | P 180,000 |
| After one year but not more than five years | **1,000,000** | **810,000** | 1,034,000 | 900,000 |
| More than five years | **557,000** | **430,000** | 700,000 | 500,000 |
| Total MLP | **1,747,000** | **1,400,000** | 1,944,000 | 1,580,000 |
| Amounts representing finance charges | **( 347,000 )** | **-** | ( 364,000) | - |
| Present value of minimum lease payments | **P 1,400,000** | **P 1,400,000** | P 1,580,000 | P 1,580,000 |

The liabilities relating to the finance leases are shown as part of Interest-bearing Loans and Borrowings (see Note 15).

PAS 17.35 (a)
PAS 17.35 (d)

### *27.3 Finance Lease – Company as Lessor*

On December 29, 2004, the Company entered into a finance lease covering certain specialized equipment with a lease term of six years. Future minimum lease payments receivable (MLPR) under this finance lease together with the PV of net minimum lease payments receivable (NMLPR) are as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Future MLPR | PV of NMLPR | Future MLPR | PV of NMLPR |
| Within one year | **P 940,000** | **756,991** | P 1,108,901 | P 943,333 |
| After one year but not more than five years | **3,390,000** | **2,910,000** | 3,990,091 | 3,773,332 |
| More than five years | **957,000** | **830,000** | 1,209,019 | 943,335 |
| Total MLP | **5,287,000** | **4,496,991** | 6,308,011 | 5,660,000 |
| Amounts representing finance charges | **( 790,009 )** | **-** | ( 648,011) | - |
| Present value of minimum lease payments | **P 4,496,991** | **P 4,496,991** | P 5,660,000 | P 5,660,000 |

The net investment relating to this finance lease is presented as Receivable under Finance Lease (current and non-current) (see Note 5).

[50] PAS 17, *Leases,* requires reconciliation between the total of minimum lease payments at the balance sheet date, and their present value. In addition, an enterprise should disclose the total of the minimum lease payments at the balance sheet date, their present value, for each of the periods disclosed above.

### *27.4 Legal Claims*

PAS 1.105 (d)(i) 33
PAS 37.89
PAS 37.91
PAS 37.92

Litigation is in process against the Company relating to a dispute with a competitor who alleges that the Company has infringed patents and seeks damages amounting to P50.0 million. The legal counsel has advised that it is probable that the Company will not be found liable. Hence, no provision for the claim has been made in the financial statements as of December 31, 2005 and 2004.

PAS 37.86

Various warranty and legal claims were brought against the Company during the year. Management considers these claims to be unjustified and the probability that they will require settlement at the Company's expense to be remote. This evaluation has been backed up by external independent legal advice.

PAS 37.92

None of these contingencies are discussed here in detail so as not to seriously prejudice the Company's position in the related disputes.

### *27.5 Capital Commitments*

As of December 31, 2005 and 2004, the Company has commitments of about P8.0 million and P10.5 million, respectively, for the acquisition of new plant and machinery.

### *27.6 Others*

As of December 31, 2005 and 2004, the Company has unused letters of credit amounting to P30.0 million and P35.0 million, respectively.

The Philippines continues to experience economic difficulties relating to currency fluctuations, volatile stock markets and slowdown in growth. Management is of the opinion that losses, if any, from these events and conditions will not have material effects on the Company's financial statements.

## 28. RISK MANAGEMENT OBJECTIVES AND POLICIES

PAS 1.105 (d)(ii)

The Company is exposed to a variety of financial risks which result from both its operating and investing activities. The Company's risk management is coordinated with its parent company, in close cooperation with the Board of Directors, and focuses on actively securing the Company's short-to medium-term cash flows by minimizing the exposure to financial markets. Long-term financial investments are managed to generate lasting returns.

PAS 32.56

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

### *28.1 Foreign currency risk*

PAS 32.76 (a)
PAS 32.76 (b)
PAS 32.79

The Company has no significant exposure to foreign currency risks as most transactions are denominated in Philippine peso, its functional currency.

### *28.2 Credit risk*

PAS 32.56

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the balance sheet (or in the detailed analysis provided in the notes to the financial statements). Credit risk, therefore, is only disclosed in circumstances where the maximum potential loss differs significantly from the financial asset's carrying amount.

The Company's trade and other receivables are actively monitored to avoid significant concentrations of credit risk.

In addition, for a significant proportion of sales, advance payments are received to mitigate credit risk. The Company has adopted a no-business policy with customers lacking an appropriate credit history where credit records are available.

### *28.3 Cash flow and fair value interest rate risks*

Cash flow and fair value interest rate risks are managed by means of derivative financial instruments, where necessary, to ensure short- to medium-term liquidity. Currently, the Company has no financial liabilities with floating interest rates.

**2005 ILLUSTRATIVE FS - ADDITONAL DISCLOSURES**
**LIST OF APPENDICES**

PAS 1.46 (a)
PAS 1.46 (b)
PAS 1.44
PAS 1.46 (c)
PAS 1.46 (d)

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**STATEMENTS OF INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippine Pesos)***

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.81 (a) | **REVENUES** | | | |
| | Sale of goods | | **P 181,171,539** | P 156,982,596 |
| | Rendering of services | | **19,900,506** | 13,334,605 |
| | Others | 19 | **5,636,837** | 4,262,264 |
| | | | **206,708,882** | 174,579,465 |
| PAS 1.91 | **COSTS AND OPERATING EXPENSES** | | | |
| | Salaries and employee benefits | 22 | **56,868,438** | 40,745,265 |
| | Raw materials and other consumables | | **38,189,134** | 29,544,476 |
| | Depreciation and amortization | | **18,176,286** | 15,373,806 |
| | Changes in inventories of finished goods and work-in-process | | **9,943,085** | 6,001,702 |
| | Outside services | | **8,369,481** | 4,486,712 |
| | Management fees | 24 | **7,000,800** | 4,975,811 |
| | Rentals | 27 | **3,771,709** | 3,335,610 |
| | Impairment losses | 5, 9, 11 | **3,206,284** | 3,356,442 |
| | Taxes and licenses | | **1,990,780** | 1,956,788 |
| | Communications | | **1,709,151** | 1,609,154 |
| | Transportation and travel | | **804,142** | 1,554,976 |
| | Others | | **1,832,844** | 1,436,932 |
| | | | **151,862,134** | 114,377,674 |
| PAS 1.83 | **OPERATING PROFIT** | | **54,846,748** | 60,201,791 |
| | **OTHER INCOME (CHARGES)** | | | |
| PAS 1.81 (b) | Finance costs | 21 | **( 11,110,130 )** | ( 10,929,530 ) |
| | Other losses (gains) - net | 21 | **( 1,531,260 )** | 1,378,911 |
| | | | **( 12,641,390 )** | ( 9,550,619 ) |
| PAS 1.83 | **INCOME BEFORE TAX** | | **42,205,358** | 50,651,172 |
| PAS 1.81 (e) | **TAX EXPENSE** | 23 | **13,257,942** | 16,318,782 |
| PAS 1.81 (f) | **NET INCOME** | 2 | **P 28,947,416** | P 34,332,390 |

***See Notes to Financial Statements.***

[1] These statements of income format illustrates an example of the "nature of expense" method (PAS 1.91).

**ABC MANUFACTURING COMPANY**
***(A Wholly Owned Subsidiary of XYZ Holdings Corporation)***
**STATEMENTS OF CHANGES IN EQUITY**
**FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**
***(Amounts in Philippine Pesos)***

| | Notes | Capital Stock [1] | Additional Paid-in Capital | Treasury Shares | Revalaution Reserves | Retained Earnings | Total Equity |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2004 | | | | | | | |
| As previously reported | | P 125,250,000 | P 7,005,000 | ( P 1,000,000 ) | P 5,270,018 | P 202,132,908 | P 338,657,926 |
| Effects of transition to PFRS, net of tax | 2 | - | - | - | ( 291,295 ) | ( 63,617,499 ) | ( 63,908,794 ) |
| As restated | | 125,250,000 | 7,005,000 | ( 1,000,000 ) | 4,978,723 | 138,515,409 | 274,749,132 |
| Fair value gains, net of tax: | | | | | | | |
| Land, building and improvements | 11 | - | - | - | 4,678,536 | - | 4,678,536 |
| Available-for-sale financial asset | 9 | - | - | - | 134,343 | - | 134,343 |
| Depreciation transfer, building and improvements | | - | - | - | ( 806,326 ) | 806,326 | - |
| Net income directly recognized in equity | | - | - | - | 4,006,553 | 806,326 | 4,812,879 |
| Net income for the year | | - | - | - | - | 34,332,390 | 34,332,390 |
| Total income recognized in 2004 | | - | - | - | 4,006,553 | 35,138,716 | 39,145,269 |
| Cash dividends | 25 | - | - | - | - | ( 13,554,600 ) | ( 13,554,600 ) |
| | | - | - | - | 4,006,553 | 21,584,116 | 25,590,669 |
| Balance at December 31, 2004 | | **P 125,250,000** | **P 7,005,000** | **( P 1,000,000 )** | **P 8,985,276** | **P 160,099,525** | **P 300,339,801** |
| Balance at January 1, 2005 | | | | | | | |
| As previously reported | | P 125,250,000 | P 7,005,000 | ( P 1,000,000 ) | P 9,344,190 | P 274,880,340 | P 415,479,530 |
| Effects of transition to PFRS, net of tax | 2 | - | - | - | ( 358,914 ) | ( 114,780,815 ) | ( 115,139,729 ) |
| As restated | | 125,250,000 | 7,005,000 | ( 1,000,000 ) | 8,985,276 | 160,099,525 | 300,339,801 |
| Fair value gains on available-for-sale financial asset, net of tax | 9 | - | - | - | 1,122,484 | - | 1,122,484 |
| Depreciation transfer, building and improvements | | - | - | - | ( 770,752 ) | 770,752 | - |
| Effects of change in income tax rate | 23 | - | - | - | ( 434,311 ) | - | ( 434,311 ) |
| Net income directly recognized in equity | | - | - | - | ( 82,579 ) | 770,752 | 688,173 |
| Net income for the year | | - | - | - | - | 28,947,416 | 28,947,416 |
| Total income recognized in 2005 | | - | - | - | ( 82,579 ) | 29,718,168 | 29,635,589 |
| Additional issuance of shares of stock | 25 | 24,750,000 | - | - | - | - | 24,750,000 |
| Cash dividends | 25 | - | - | - | - | ( 21,980,000 ) | ( 21,980,000 ) |
| | | 24,750,000 | - | - | ( 82,579 ) | 7,738,168 | 32,405,589 |
| Balance at December 31, 2004 | | **P 150,000,000** | **P 7,005,000** | **( P 1,000,000 )** | **P 8,902,697** | **P 167,837,693** | **P 332,745,390** |

***See Notes to Financial Statements.***

[1] If there are only few details, show on the face of the statement the number of authorized, issued, and subscribed shares and par value.

## ADDITIONAL DISCLOSURES FOR COMPANIES THAT DERIVE INCOME FROM CONSTRUCTION CONTRACTS

### CONSTRUCTION CONTRACTS

PAS 11.3 *A construction contract is defined in PAS 11 as a contract specifically negotiated for the construction of an asset.*

### BALANCE SHEETS (Extract)

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.51 | **CURRENT ASSETS** | | | |
| PAS 1.68(h) | Trade and other receivables | 5 | **2,328,000** | 2,034,000 |
| PAS 1.51 | **CURRENT LIABILITIES** | | | |
| PAS 1.68(j) | Trade and other payables | 12 | **1,865,000** | 1,361,000 |

### STATEMENTS OF INCOME (Extract)

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 11.39(a) | **CONTRACT REVENUE** | | **52,698,123** | 48,698,154 |
| PAS 1.68(h) | **CONTRACT COSTS** | 16 | **48,389,756** | 45,389,784 |
| PAS 1.51 | **GROSS PROFIT** | | **4,308,367** | 3,308,370 |
| PAS 1.68(j) | **OPERATING EXPENSES** | | | |
| | Selling and marketing costs | 17 | **1,467,335** | 1,235,158 |
| | Administrative expenses | 17 | **398,112** | 598,112 |
| | Other operating expenses | 17 | **34,215** | 58,215 |

## Notes – ACCOUNTING POLICIES

***Construction Contracts***

PAS 11.39 (b-c)

Contract costs are recognized when incurred.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recovered.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognized over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately.

PAS 11.31

The Company uses the percentage of completion method to determine the appropriate amount to recognize in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, prepayments or other assets, depending on their nature.

The Company presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognized profits (less recognized losses) exceed progress billings. Progress billings not yet paid by customers and retention are included within Trade and Other Receivables.

The Company presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognized profits (less recognized losses).

**Note 5 – TRADE AND OTHER RECEIVABLES**

This account is composed of the following:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Trade receivables | | **P1,817,000** | P1,694,000 |
| Allowance for impairment | | **( 10,000)** | ( 7,000) |
| | | **1,807,000** | 1,687,000 |
| Loans to related parties | x | **266,000** | 138,000 |
| Prepayments | | **130,000** | 114,000 |
| Amounts due from customers for contract work | | **98,000** | 78,000 |
| Receivables from related parties (Note xx) | x | **54,000** | 4,000 |
| Retentions receivables | | **23,000** | 13,000 |
| | | **P2,328,000** | P2,034,000 |

The aggregate amount of costs incurred and recognized profits (less recognized losses) for all contracts in progress at the balance sheet date were P7,515,000 in 2005 and P6,083,000 in 2004.

**Note 12 – TRADE AND OTHER PAYABLES**

This account is consists of the following:

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Trade payables | | **P 1,098,000** | P 939,000 |
| Accrued expenses | | **148,000** | 82,000 |
| Advances received for contract work | | **214** | 131,000 |
| Amounts due to related parties | x | **220** | 119,000 |
| Amounts due to customers for contract work | | **185** | 90,000 |
| | | **P 1,865,000** | P 1,361,000 |

## ADDITIONAL DISCLOSURES FOR COMPANIES THAT DERIVE INCOME FROM SALE OF AGRICULTURE PRODUCTS

### AGRICULTURE

PAS 28.5 — *Agriculture activity is defined as the management by an enterprise of the biological transformation of biological assets for sale into agricultural produce or into additional biological assets.*

### BALANCE SHEETS (Extract)

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.51 | **CURRENT ASSETS** | | | |
| PAS 1.68(g) | Inventories | 6 | **22,605,865** | 26,899,398 |
| PAS 1.51 | **NON-CURRENT ASSETS** | | | |
| PAS 1.68(a) | Property and equipment | 11 | **18,698,154** | 19,845,632 |
| PAS 41.39 | Biological assets | 12 | **12,569,123** | 9,587,456 |

### STATEMENTS OF INCOME (Extract)

| | Notes | 2005 | 2004 |
|---|---|---|---|
| **REVENUES** | | | |
| Fair value of milk produced | | **32,698,123** | 28,698,154 |
| Gain arising from changes in fair value less estimated point-of-sale costs of biological assets | | **8,389,756** | 5,389,784 |

### Note – COMPANY INFORMATION

D&M Company is engaged in milk production for supply to various customers. As of December 31, 2005, the Company held 419 cows able to produce milk (mature assets) and 137 heifers that are being raised to produce milk in the future (immature assets). The Company produced 157,584 kg of milk with a fair value less estimated point-of-sale costs of P518,240 (that is determined at the time of milking) in the year ended December 31, 2005.

## Notes – ACCOUNTING POLICIES

***Livestock and Milk***

PAS 1.110 (b-c)

PAS 41.47

Livestock are measured at their fair value less estimated point-of-sale costs. The fair value of livestock is determined based on market prices of livestock of similar age, breed and generic merit. Milk is initially measured at its fair value less estimated point-of-sale costs at the time of milking. The fair value of milk is determined based on market prices in the local area.

## Note – BIOLOGICAL ASSETS

| | Notes | 2005 | 2004 |
|---|---|---|---|
| Beginning of the year | | **P2,960,000** | P3,457,000 |
| Increases due to purchases | | **2,625,000** | 1,535,000 |
| Gain arising from changes in fair value less estimated point-of-sale costs attributable to physical changes * | | **153,000** | 144,000 |
| Gain arising from changes in fair value less estimated point-of-sale costs attributable to price changes * | | **240,000** | 258,000 |
| Decreases due to sales | | **(1,318,000)** | (2,434,000) |
| End of the year | | **P 4,660,000** | P 2,960,000 |

* Separating the increase in fair value less estimated point-of-sale costs between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by PAS 40.

## ADDITIONAL DISCLOSURES

## PROPERTY, PLANT AND EQUIPMENT – At Costs

***Note:*** *The following are the relevant accounting policy disclosures if the Company's Property, Plant and Equipment account is stated at cost.*

## Notes – ACCOUNTING POLICIES

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

#### *3.1 Basis of Preparation*

PAS 1.14

The financial statements of ABC Manufacturing Company have been prepared in accordance with generally accepted accounting principles in the Philippines as set forth in PFRSs.

The financial statements have been prepared on the historical cost basis. The measurement basis is more fully described in the accompanying accounting policies below.

It should be noted that accounting estimates and assumptions are used in preparing the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.[1]

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

PAS 1.110

#### *3.7 Property, Plant and Equipment*

Land held for use in production or administration is stated at cost. As no finite useful life for land can be determined, the related carrying amounts are not depreciated.

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[1] The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements should be disclosed, hence, the above paragraph should be modified accordingly.

Buildings and improvements, machinery and equipment, office furniture, fixtures and other equipment and transportation equipment are carried at acquisition cost or construction cost less subsequent depreciation and impairment losses.

PAS 16.73 (a)

The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, their cost and related accumulated depreciation and impairment losses are removed from the accounts and any resulting gain or loss is reflected in income for the period.

PAS 16.73 (b)

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

PAS 16.73 (c)

| | |
|---|---|
| Buildings and improvements | 10-20 years |
| Machinery and equipment | 5-12 years |
| Office furniture, fixtures and other equipment | 5-10 years |
| Transportation equipment | 3-5 years |

Transportation equipment held under finance lease agreements (see Note 3.14) are depreciated over their expected useful lives (determined by reference to comparable owned assets) or over the term of lease, if shorter.

PAS 36.59

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount
(see Note 3.16).

PAS 16.51

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

PAS 16.68, 71

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

## ADDITIONAL DISCLOSURES

## INVESTMENTS IN ASSOCIATES - AT EQUITY

***Note:*** *The following are the relevant FS presentation and disclosure for Investments in Associate accounted for at equity. See PAS 28.13 for guidance on when to account for Investments in Associate at equity.*

### BALANCE SHEETS (Extract)

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.51 | **NON-CURRENT ASSETS** | | | |
| PAS 1.68(d) | Long-term financial assets | 9 | **33,422,701** | 34,931,355 |
| PAS 1.68(e) | Investments in associates | 10 | **37,230,120** | 31,604,876 |

### STATEMENTS OF INCOME (Extract)

| | | Notes | 2005 | 2004 |
|---|---|---|---|---|
| PAS 1.83 | **OPERATING PROFIT** | | **54,846,748** | 60,201,791 |
| | **OTHER INCOME (CHARGES)** | | | |
| PAS 1.81 (b) | Finance costs | | **(11,110,130)** | (10,929,530) |
| PAS 1.81 (c) | Equity in net earnings of associates | 10 | **18,865,644** | (12,654,456) |

## Note 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *3.6 Financial Assets …..*

PAS 1.110

### *3.7 Investments in Associates*[1]

PAS 28.13

Associates are those entities over which the Company is able to exert significant influence but which are neither subsidiaries nor interests in a joint venture. Investments in associates are initially recognized at cost and subsequently accounted for using the equity method.

Acquired investments in associates are also subject to purchase accounting. However, any goodwill or fair value adjustment attributable to the share in the associate is included in the amount recognized as investments in associates. Goodwill is the excess of the acquisition cost over the fair value of the Company's chare of the identifiable net assets of the investee at the date of acquisition.

All subsequent changes to the ownership interest in the equity of the associates are recognized in the Company's carrying amount of the investments. Changes resulting from the profit or loss generated by the associates are credited or charged against the Equity in Net Earnings (Losses) of Associates account in the Company's statement of income. Items that have been directly recognized in the associates' equity are recognized in equity of the Company. Any non-income related equity movements of the associates that arise, for example, from the distribution of dividends or other transactions with the associate's shareholders are charged against the proceeds received or granted.

When the Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

PAS 28.22
PAS 28.26

Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset acquired from the transaction with the associate. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company.

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1 The investor shall apply the requirements of PAS 39 to determine whether any impairment loss should be recognized on its investments. If there is an indication of imapairment, the entities carrying amount of the investment (including goodwill) shall be tested for impairment under PAS 36.

## Note 10 - INVESTMENTS IN ASSOCIATES

The components of the carrying amount of investments in associates accounted for under the equity method are as follows:

| | % Interest Held | **2005** | 2004 |
|---|---|---|---|
| Acquisition costs: | | | |
| Trio Company | 40% | **P23,500,000** | P 23,500,000 |
| Zire, Inc. | 30% | **15,000,000** | 11,250,000 |
| Tungs Ltd. | 25% | **5,000,00** | 5,000,000 |
| | | **38,500,000** | 34,750,000 |
| Equity in net earnings: | | | |
| Balance at beginning of year | | **4,755,720** | 12,156,220 |
| Equity in net earnings (losses) | | **6,870,950** | ( 5,900,500) |
| Dividends received | | **( 1,500,000)** | ( 1,500,000) |
| PAS 28.38(d) Balance at end of year | | **10,126,670** | 4,755,720 |
| | | **P48,626,670** | P 39,505,720 |

PAS 28.37(a) All of the above associates are incorporated in the Philippines whose shares of stock are not listed in the stock exchange and, hence, the fair value of its shares cannot be determined reliably.

In June 2005, the Company made an additional investment in shares of Zire, Inc. amounting to P3,750,000 which increased the Company's ownership interest in the investee from 25% to 30%.

The balance of the equity in net earnings of P10.1 million and P4.8 million as of December 31, 2005 and 2004, respectively, which is lodged in the Company's retained earnings as of those dates is not available for declaration as dividends by the Company.

PAS 28.37(b)

The Company's share[2] in the results of operations of associates and in their assets and liabilities (including goodwill) are as follows:

| | Assets | Liabilities | Revenues | Income (Loss) |
|---|---|---|---|---|
| 2005: | | | | |
| Trio Company | P 40,654,154 | P 24,587,963 | P 30,548,123 | P 6,354,124 |
| Zire, Inc. | 33,564,981 | 10,569,456 | 8,546,789 | (1,356,897) |
| Tungs Ltd. | 25,549,781 | 15,894,827 | 14,598,789 | 1,873,723 |
| | **P 99,768,916** | **P 51,142,246** | **P 53,692,701** | **P 6,870,950** |
| 2004: | | | | |
| Trio Company | P 47,659,234 | P 32,584,965 | P 20,548,123 | P 2,356,344 |
| Zire, Inc. | 23,564,952 | 10,546,328 | 5,546,723 | ( 5,356,897) |
| Tungs Ltd. | 28,549,541 | 17,136,714 | 8,554,419 | ( 2,899,947) |
| | **P99,683,727** | **P60,268,007** | **P34,649,265** | **(P5,900,500)** |

The carrying amount of goodwill as of December 31, 2005 and 2004 included in the carrying value of Investments in Associates amounted to P3.5 million in both years.

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[2] Alternatively, the Company may present the gross amount of the assets and liabilities (excluding goodwill) of associates.

## REPORT OF INDEPENDENT AUDITORS
## (For NPAEs)

**The Board of Directors**
**Small Business, Inc.**

8 Just Around the Corner
Little Town, Makati City [1]

We have audited the accompanying balance sheets of Small Business, Inc. as of December 31, 2005 and 2004, and the related statements of income, changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the 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 generally accepted auditing standards 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Small Business, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles in the Philippines.

**PUNONGBAYAN & ARAULLO**

**By: Gregorio S. Navarro**
Partner
CPA Reg. No. 0033571
TIN 109-228-435
PTR No. 4182116, January 4, 2006, Makati City
Partner SEC Accreditation No. 0013-AR-1
BIR AN 08-002511-2-2005 (Dec. 27, 2005 to 2008)

February 28, 2006

[1] It is assumed that this set of financial statements is for submission to the SEC and BIR.

## APPLICABLE DISCLOSURES FOR NPAEs WHICH HAVE ADOPTED <u>SOME</u> OF THE PFRSs

***Note*:** *An entity which qualified as an NPAE and opted to adopt* ***some*** *of the relevant PFRSs which became effective for the periods beginning or on after January 1, 2005 is still* ***not considered as first-time adopter of PFRS*** *since it has not fully adopted all relevant PFRSs. Hence, Note 2, "Transitioning to PFRS" in the 2005 Illustrative FS for ABC Company is not applicable to such entity. The new PFRSs adopted and their effects should be disclosed in the note on "Change in Accounting Policies" (see sample in Note 3 below).*

*The following are the relevant disclosures for NPAE who adopted some of the PFRSs:*

## Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### *2.1 Basis of Preparation*

PAS 1.14

The financial statements of Small Business, Inc. have been prepared in accordance with generally accepted accounting principles in the Philippines applicable to non-publicly accountable entities (NPAEs) as set forth in Philippine Accounting Standards (PAS) 101, *Financial Reporting Standards for NPAEs*, issued and approved by the Accounting Standard Council (ASC) and the Securities and Exchange Commission (SEC), effective for periods beginning on or after January 1, 2005 to 2007. PAS 101 provides an option to NPAEs to apply financial reporting standards effective as of December 31, 2004, and not to apply any of the new Philippine Accounting Standards (PASs) and Philippine Financial Reporting Standards (PFRSs) that became effective in 2005, or to apply all or some of the relevant new accounting standards.

The Company has qualified as an NPAE under PAS 101 and it has opted to apply the applicable financial reporting standards effective as of December 31, 2004, and some of the PASs and PFRSs that became effective in 2005, which are relevant to the Company. The adoption of these new and revised accounting standards is more fully discussed in Note 3.

The financial statements have been prepared on the historical cost basis. The measurement bases are more fully described in the accounting policies below.

It should be noted that accounting estimates and assumptions are used in preparing the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.[1]

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

**XXX**

*[**Note:** Accounting policies and related disclosures of the PFRSs adopted should be revised based on the requirement of specific PFRS (refer to 2005 Illustrative FS of ABC Company for sample disclosures). GAAP applied based on standards effective as of December 31, 2004 should be retained (refer to the 2004 Illustrative FS for ABC for sample disclosures).*

## Note 3 – CHANGE IN ACCOUNTING POLICIES

PAS 1.105 (b) In 2004, the ASC issued a series of new accounting standards that are adopted from International Accounting Standards (IASs), revised IASs and new International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). The new ASC accounting standards are effective in the Philippines for financial statements covering periods beginning on or after January 1, 2005.

Also, to correspond better with the issuances of the IASB, the ASC re-named the Standards it issues as PFRSs (previously referred to as Statements of Financial Accounting Standards or SFASs). PFRSs consist of:

a. PFRSs (corresponding to IFRSs);
b. PASs (corresponding to IASs); and,
c. Interpretations (corresponding to IFRICs and SICs).

[1] The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements should be disclosed, hence, the above paragraph should be modified accordingly. See Appendix 2.5 for sample disclosures.

Of the new ASC pronouncements[2], the following are the standards adopted by the Company effective January 1, 2005:

| | | |
|---|---|---|
| PAS 1 | : | Presentation of Financial Statements |
| PAS 8 | : | Accounting Policies, Changes in Accounting Estimates and Errors |
| PAS 10 | : | Events after the Balance Sheet Date |
| PAS 16 | : | Property, Plant and Equipment |

The requirements of these new standards have been applied in accordance with their specific transitional provisions, or retrospectively in accordance with PAS 8, in the absence of such specific transitional provisions.

The Company's adoption of these new and revised PASs and PFRSs did not result in material adjustments to the financial statements of the current and prior years, except for the reclassification of certain accounts in the 2004 financial statements to be consistent with the 2005 financial statement presentation.[3]

2 See AA 2005-01 for the complete list of new and revised accounting standards effective for the periods beginning on or after January 1, 2005.

3 If the adoption of any of the standards results in material adjustments, the significant effects on the FS should be disclosed (refer to the 2004 Illustrative FS of ABC Company for sample disclosures).

## APPLICABLE DISCLOSURES FOR NPAE WHICH HAS NOT ADOPTED PFRSs

***Note*:** *An entity which qualified as an NPAE and opted* ***not to adopt*** *any of the relevant PFRSs which became effective for the periods beginning or on after January 1, 2005, the note on the "Basis of Preparation" should be modified to indicate that the financial statements are prepared in accordance with the standards effective as of December 31, 2004. (Refer to 2004 Illustrative FS of ABC Company for sample note disclosures.)*

*Below is the modified "Basis of Preparation" applicable to NPAEs which will not adopt any of the relevant PFRSs.*

## Note 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### *2.1 Basis of Preparation*

The financial statements of Small Business, Inc. have been prepared in accordance with generally accepted accounting principles in the Philippines applicable to non-publicly accountable entities (NPAEs) as set forth in Philippine Accounting Standards (PAS) 101, *Financial Reporting Standards for NPAEs*, issued and approved by the Accounting Standard Council (ASC) and the Securities and Exchange Commission (SEC), effective for periods beginning on or after January 1, 2005 to 2007. PAS 101 provides an option to NPAEs to apply financial reporting standards effective as of December 31, 2004, and not to apply any of the new Philippine Accounting Standards (PASs) and Philippine Financial Reporting Standards (PFRSs) that became effective in 2005, or to apply all or some of the relevant new standards.

The Company has qualified as an NPAE under PAS 101 and it has opted not to apply any PFRSs that became effective in 2005. Accordingly, the applicable financial reporting standards effective as of December 31, 2004 were applied in the preparation of the financial statements for the years ended December 31, 2005 and 2004.

The financial statements have been prepared on the historical cost basis. The measurement bases are more fully described in the accounting policies below.

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