

BANCO DE LA NACIÓN

Financial Statements

December 31, 2012 and 2011

(Including Independent Auditors' Report)

**(TRANSLATION OF FINANCIAL STATEMENTS
ORIGINALLY ISSUED IN SPANISH)**



KPMG en Perú
Torre KPMG. Av. Javier Prado Oeste 203
San Isidro. Lima 27, Perú

Teléfono 51 (1) 611 3000
Fax 51 (1) 421 6943
Internet www.kpmg.com/pe

(TRANSLATION OF A REPORT ORIGINALLY ISSUED IN SPANISH)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Banco de la Nación

We have audited the accompanying financial statements of Banco de la Nación, which comprise the balance sheet as of December 31, 2012 and 2011, and the related statements of income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting standards established by the Superintendencia de Banca, Seguros y Administradoras Privadas de Fondos de Pensiones - SBS (Superintendence of Banking, Insurance and Pension Fund Administrators) for financial institutions in Peru, and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing approved for its application in Peru by the Dean's Council of the Peruvian Professional Associations of Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

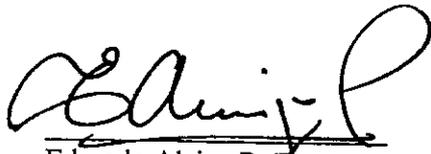
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Banco de la Nación as of December 31, 2012 and 2011, and its financial performance and its cash flows for the year then ended in accordance with accounting standards established by the SBS for financial institutions in Peru.

Lima, Peru

March 11, 2013

Countersigned by:

Coipo y Asociados



Eduardo Alejos P. (Partner)
Peruvian Certified Public Accountant
Registration number 01-29180

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Financial Statements
December 31, 2012 and 2011

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(TRANSLATION OF FINANCIAL STATEMENTS ORIGINALLY ISSUED IN SPANISH)

BANCO DE LA NACIÓN

Balance Sheet

December 31, 2012 and 2011

(stated in thousands of nuevos soles)

| | Note | 2012 | 2011 |
|---|------|-------------------|-------------------|
| Assets: | | | |
| Cash and cash equivalents: | | | |
| Cash | | 1,134,813 | 758,837 |
| Central Reserve Bank of Peru | 5 | 11,226,622 | 12,343,529 |
| Banks and other entities of local financial system | | 20,842 | 20,605 |
| Banks and other entities of foreign financial system | | 242,739 | 148,953 |
| Clearing account | | 44,170 | 74,183 |
| Accrued interest and due from banks and other | | 48,823 | 27,654 |
| | | <u>12,718,009</u> | <u>13,373,761</u> |
| Trading and held-to-maturity investments | | 4,939,025 | 3,285,494 |
| Loan portfolio, net | 6 | 5,587,425 | 4,965,186 |
| Accounts receivable, net | 8 | 283,240 | 337,615 |
| Property, furniture, and equipment, net | 9 | 296,964 | 303,483 |
| Deferred income tax | 10 | 64,351 | 88,573 |
| Other assets, net | 11 | 290,163 | 294,085 |
| | | <u>24,179,177</u> | <u>22,648,197</u> |
| Total assets | | | |
| Contingent and memoranda accounts | | | |
| Contingent operations | 19 | 1,790,501 | 2,023,433 |
| Memoranda accounts | | 64,933,521 | 67,853,175 |
| Trust and commissions of a trustee | | 1,248,952 | 1,458,748 |
| | | <u>67,972,974</u> | <u>71,335,356</u> |
| Liabilities: | | | |
| Deposits and obligations | | | |
| Deposits from financial system enterprises and international financial entities | 12 | 21,338,884 | 20,030,142 |
| Accounts payable | 13 | 382,940 | 371,466 |
| Provisions | 14 | 163,505 | 148,575 |
| Other liabilities | 15 | 102,824 | 119,383 |
| | 16 | 128,192 | 136,782 |
| | | <u>22,116,345</u> | <u>20,806,348</u> |
| Total liabilities | | | |
| Equity: | | | |
| Share capital | 17 | 1,000,000 | 1,000,000 |
| Additional capital | | 952 | 677 |
| Legal reserve | | 350,000 | 350,000 |
| Unrealized results | | 43,076 | 4,457 |
| Retained earnings | | 668,804 | 486,715 |
| | | <u>2,062,832</u> | <u>1,841,849</u> |
| Total liabilities and equity | | <u>24,179,177</u> | <u>22,648,197</u> |
| Contingent and memoranda accounts | | | |
| Contingent operations | 19 | 1,790,501 | 2,023,433 |
| Memoranda accounts | | 64,933,521 | 67,853,175 |
| Trust and commissions of a trustee | | 1,248,952 | 1,458,748 |
| | | <u>67,972,974</u> | <u>71,335,356</u> |

The accompanying notes are an integral part of these financial statements.

BANCO DE LA NACIÓN

Income Statement

For the years ended December 31, 2012 and 2011

(stated in thousands of nuevos soles)

| | Note | 2012 | 2011 |
|-------------------------------------|-------|-----------------------|-----------------------|
| Finance income | 20 | 1,174,382 | 1,091,247 |
| Finance expense | 21 | (69,389) | (79,033) |
| Gross finance margin | | <u>1,104,993</u> | <u>1,012,214</u> |
| Provision for direct doubtful loans | | (22,449) | (22,997) |
| Revenue from decrease in provisions | | 1,445 | 23,634 |
| Net finance margin | | <u>1,083,989</u> | <u>1,012,851</u> |
| Income from finance services | 22 | 599,722 | 555,525 |
| Expenses from finance services | | (69,733) | (53,631) |
| Operating margin | | <u>1,613,978</u> | <u>1,514,745</u> |
| Administrative expenses | 23 | (729,843) | (879,655) |
| Net operating margin | | <u>884,135</u> | <u>635,090</u> |
| Assets valuation and provisions | 24 | (84,807) | (100,584) |
| Operating results | | <u>799,328</u> | <u>534,506</u> |
| Other income and expenses, net | 25 | 35,776 | 25,124 |
| Profit before tax | | <u>835,104</u> | <u>559,630</u> |
| Income tax | 27(g) | (166,300) | (72,915) |
| Net income for the year | | <u><u>668,804</u></u> | <u><u>486,715</u></u> |

The accompanying notes are an integral part of these financial statements.

BANCO DE LA NACIÓN

Statement of Changes in Equity

For the years ended December 31, 2012 and 2011

(stated in thousands of nuevos soles)

| | Share capital (note 17(a)) | Additional capital | Legal reserve (note 17(b)) | Unrealized results | Retained earnings (note 17(c)) | Total equity |
|---|----------------------------------|-----------------------|----------------------------------|-----------------------|--------------------------------------|-----------------|
| Balance as of January 1, 2011 | 1,000,000 | 677 | 350,000 | (6,853) | 381,853 | 1,725,677 |
| Adjustment to deferred workers' profit sharing | - | - | - | - | (13,196) | (13,646) |
| Previous year other adjustments | - | - | - | (450) | 3,339 | 3,339 |
| Distribution to Public Treasury | - | - | - | - | (311,996) | (311,996) |
| Compensation of debt with Public Treasury | - | - | - | - | (60,000) | (60,000) |
| Unrealized results from available-for-sale investments | - | - | - | 11,760 | - | 11,760 |
| Net income for the year | - | - | - | - | 486,715 | 486,715 |
| Balance as of December 31, 2011 | 1,000,000 | 677 | 350,000 | 4,457 | 486,715 | 1,841,849 |
| Donations | - | 275 | - | - | - | 275 |
| Previous year other adjustments | - | - | - | - | (7,430) | (7,430) |
| Distribution to Public Treasury | - | - | - | - | (335,499) | (335,499) |
| Compensation of debt with Public Treasury | - | - | - | - | (143,786) | (143,786) |
| Unrealized net results from available-for-sale investments | - | - | - | 38,619 | - | 38,619 |
| Net income for the year | - | - | - | - | 668,804 | 668,804 |
| Balance as of December 31, 2012 | 1,000,000 | 952 | 350,000 | 43,076 | 668,804 | 2,062,832 |

The accompanying notes are an integral part of these financial statements.

BANCO DE LA NACIÓN

Statement of Cash Flows

For the years ended December 31, 2012 and 2011

(stated in thousands of nuevos soles)

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|-------------------|
| Cash flows from operating activities: | | |
| Net income for the year | 668,804 | 486,715 |
| Adjustments to reconcile the net income for the year to cash from operating activities: | | |
| Depreciation and amortization | 47,746 | 46,053 |
| Provision for direct doubtful loan losses | 22,449 | 22,997 |
| Provision reversal | (20,121) | (23,634) |
| Provision for accounts receivable | 14,220 | 10,658 |
| Provision for assets received as payment, repossessed, and no-longer-in-use | - | 1 |
| Provision for contingencies and other | 22,085 | 42,522 |
| Deferred income tax | 5,560 | (10,799) |
| Other changes in property, furniture and equipment | 13,751 | 5,819 |
| Gain on sale of investments | (12,556) | (13,758) |
| Accounting restructuring | 2,505 | (3,296) |
| Debits and credits due to net changes in assets and liabilities: | | |
| Interest, commissions and other accounts receivable | 25,233 | (55,195) |
| Interest, commissions and other accounts payable | (65,496) | 17,574 |
| Other liabilities | (10,651) | 11,984 |
| Other assets | (3,932) | (1,294) |
| Equity adjustments | (7,430) | - |
| Net cash and cash equivalents from operating activities | 702,167 | 536,347 |
| Cash flows from investing activities: | | |
| Purchase of property, furniture, and equipment | (45,769) | (40,722) |
| Purchase of other non-financial assets | (9,791) | (3,387) |
| Net cash and cash equivalents used in investing activities | (55,560) | (44,109) |
| Cash flows from financing activities: | | |
| Net increase in deposits and other obligations | 1,400,995 | 1,295,056 |
| Payment of profits to Public Treasury | (335,499) | (311,996) |
| Net increase in loan portfolio | (650,364) | (718,532) |
| Net increase in investment securities | (1,727,620) | (161,115) |
| Dividends received | 1,420 | 1,003 |
| Net decrease in other financial assets | 8,709 | 51,769 |
| Net cash and cash equivalents (used in) from financing activities | (1,302,359) | 156,185 |
| Net (decrease) increase in cash and cash equivalents | (655,752) | 648,423 |
| Cash and cash equivalents at the beginning of the year | 13,373,761 | 12,725,338 |
| Cash and cash equivalents at the end of the year | <u>12,718,009</u> | <u>13,373,761</u> |

Non-cash flow generating transactions:

As of December 31, 2012, the debt compensation between Banco de la Nación and the Ministry of Economy and Finance of S/. 143,786 thousand has not been considered in the preparation of the statement of cash flow as of that date because they do not represent cash flows (S/. 60,000 thousand as of December 31, 2011).

The accompanying notes are an integral part of these financial statements.

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Notes to the Financial Statements

December 31, 2012 and 2011

(1) Operations

Banco de la Nación (hereinafter the Bank) was incorporated by Law N° 16000 dated January 27, 1966, as an entity ruled by public law belonging to the Economy and Finance Sector and operating with economic, financial and administrative autonomy. Subsequently, its Incorporation Act was updated through Legislative Decree N° 199 dated June 12, 1981. Since November 27, 1992, when issuing the Decree Law N° 25907, exclusive rights concerning functions and powers contained in section III of the Organic Law then in force, were no longer in effect.

The Bank is governed by its bylaws approved by Supreme Decree N° 07-94-EF dated January 26, 1994, amended by Emergency Decree N° 31-94 dated July 11, 1994, by the State Business Activity Act and supplementary by the General Act on the Financial and Insurance Systems and Organic Law of the Banking, Insurance and Pension Plan Fund Administrator (hereinafter SBS) Law N° 26702 (hereinafter the Banking Act).

The Bank is entitled to perform the following functions which none of them will be exclusively performed by entities of the financial system:

- a. Provide banking services to the National Treasury System according to the instructions enacted by the General Treasury Directorate. Such services will be offered as any other entity of the financial system.
- b. Provide tax collection services on behalf of tax creditor, that should be approved by the Bank and also there should be a specific tax collection agreement.
- c. Conduct, by delegation, transactions pertaining to sub-accounts of the Public Treasury.
- d. Receive resources and funds from Central, Regional and Local Government entities, as well as other entities of the National Public Sector.
- e. Act as Government financial agent.
- f. Act on behalf of other banks or financial entities in funneling domestic or foreign resources to credit institutions.
- g. Participate in foreign trade operations of the Government, as indicated in its bylaws. In this case, the Bank renders banking and money exchange services, under to the regulations enacted by the Central Reserve Bank of Peru.
- h. Receive all administrative and judicial deposits under consignment and custody.
- i. Provide banking services as a correspondent of financial system entities where financial system entities request it.
- j. Receive demand deposits from individuals and corporations for payments as suppliers, pensioners, as well as Government workers within the framework of the National Treasury System.
- k. Receive saving and custody deposits from individuals and corporations located in populated centers within the territory of the country where private banks do not have offices, including the issuance of wire transfers, and transfer of funds ordered or in favor of such persons.

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Notes to the Financial Statements

- l. Grant loans and financial facilities to National, Regional and Local Government entities and other entities of the National Public Sector, except for granting loans to State companies incorporated under private law, as well as issuing, acquiring, maintaining and selling bonds and other securities as set forth by law. The issuance of securities will be made according to an annual schedule approved by the Ministry of Economy and Finance that may be reviewed quarterly.
- m. Conduct with Public sector entities and banking and financial institutions within the country and abroad, the transactions and banking services necessary indicated in the bylaws, as well as those aimed to generate profits and hedge risks of those managed resources. These transactions will be made according to an annual plan approved by the Ministry of Economy and Finance that can be reviewed quarterly.
- n. Grant a single line of credit to workers and pensioners from the public sector that due to their income, have saving accounts in the Bank. Such line of credit may be assigned to the beneficiary for use through loans and/ or line of credit card. These transactions will be made according to an annual schedule approved by the Ministry of Economy and Finance that can be reviewed annually.

Bank's head office is located at Av. República de Panamá N° 3664, San Isidro, Lima, Peru. The Bank operates through its main office and a network of 27 branches, and 507 agencies and offices located in the country (in 2011, it had 27 branches and 509 agencies and offices).

As of December 31, the number of Bank's workers is as follows:

| | <u>2012</u> | <u>2011</u> |
|----------|--------------|--------------|
| Managers | 17 | 19 |
| Officers | 908 | 920 |
| Staff | 3,293 | 3,189 |
| | ----- | ----- |
| | <u>4,218</u> | <u>4,128</u> |

Settlement with the Ministry of Economy and Finance

Supreme Decree N° 002-2007-EF dated January 11, 2007, the Ministry of Economy and Finance (hereinafter MEF) repealed the Supreme Decree N° 210-2006-EF dated December 27, 2006, that stipulated among other matters, the reconciliation of other reciprocal obligations held by the MEF and the Bank as of September 30, 2006, entering into a settlement agreement on December 28, 2006.

Supreme Decree N° 002-2007-EF dated December 28, 2006, ratified the settlement agreement of reciprocal obligations between the MEF and the Bank and established that the compensation and total settlement of obligations of the MEF in favor of the Bank would be made on January 2, 2007; thus, all obligations should have been reconciled as of January 1, 2007, including other reciprocal debts that were updated applying the same criteria established in the agreement signed on December 28, 2006.

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Notes to the Financial Statements

Reciprocal debts reconciled as of January 1, 2007 as a result of the Settlement Agreement on Obligations, signed on February 28, 2007, resulted in debts of the MEF in favor of the Bank for US\$ 31,335 thousand and debts of the Bank in favor of the MEF for US\$ 72,414 thousand, obtaining a net debt in favor of the MEF for US\$ 41,079 thousand.

Likewise, in the settlement agreement on obligations between the MEF and the Bank dated January 1, 2007, additional borrowing of MEF was determined in favor of the Bank for S/. 64,338 thousand and US\$ 849,171 thousand, resulting from various borrowing operations approved by explicit legal norms.

As a consequence of the settlement agreement on reciprocal obligations signed between MEF and the Bank on December 28, 2006 and January 1, 2007, the total compensated reciprocal debt is as follows:

| | <u>In thousands of</u> | |
|-----------------------------------|------------------------|----------------|
| | <u>S/.</u> | <u>US\$</u> |
| Debt of MEF in favor of the Bank: | | |
| December 28, 2006 agreement | - | 31,335 |
| January 1, 2007 agreement | 64,338 | 849,171 |
| Debt of the Bank in favor of MEF: | | |
| December 28, 2006 agreement | - | (72,414) |
| Debt of MEF in favor of the Bank | <u>64,338</u> | <u>808,092</u> |

According to the Supreme Decree N° 002-2007-EF, refined by the Consolidation, Compensation and Settlement of Obligations Agreement entered between the MEF and the Bank on March 26, 2007, the following conditions resulted from the compensation of reciprocal obligations between the MEF and the Bank were:

- a) The MEF compensated the debt in favor of the Bank providing on March 30, 2007 a bond in nuevos soles for S/. 2,644,571 thousand (note 6); therefore, the debt in U.S. dollars was converted at the selling exchange rate published by the SBS at closing of operations on January 2, 2007 for S/. 3.193 per US\$ 1.
- b) The bond was issued under the following characteristics:
 - Denominated in nuevos soles
 - Non negotiable
 - 30-year maturity
 - Annually redeemable
 - 6.3824% annual interest paid quarterly
 - CAVALI S.A. I.C.L.V. account entry
- c) Bond annual amortization is an amount equivalent to no less than 30% of Bank's profits corresponding to the Public Treasury. In any case, the amortization cannot be lower than S/. 60,000 thousand. If profits corresponding to the Public Treasury do not allow complying with such amount, the MEF will cover the difference charging it to budget items allocated to the public debt service.

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Notes to the Financial Statements

- d) In case there were outstanding balances at bond's maturity date, they will be paid by the MEF.
- e) Bond's accrued interest will be paid by the MEF.

Bond's balances as of December 31, 2012 and 2011 amount to S/. 1,745,722 thousand and S/. 1,889,890 thousand, respectively (note 6).

Approval of Financial Statements

In Board of Directors' Meeting N° 1895, held on March 21, 2012, the financial statements for the year ended December 31, 2011 were approved. On January 31, 2013, management approved the financial statements as of December 31, 2012, which will be submitted to Board of Directors for their corresponding approval at management's decision. In management's opinion, Board of Directors will approve the accompanying financial statements without modifications.

(2) Basis of Preparation of Financial Statements

(a) Statement of Compliance

The accompanying financial statements have been prepared from the Bank's accounting records balances, and are presented in accordance with accounting standards and practices enacted by the SBS using its authority conferred as established by the Banking Act.

The SBS has established that for situations not foreseen in such standards, the International Financial Reporting Standards (IFRS) officially approved for its application in Peru by the Peruvian Accounting Board (CNC) will be applied. Such standards comprise the standards and interpretations issued or adopted by the International Accounting Standards Board (IASB), which include the International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), and the pronouncements issued by the International Financial Reporting Interpretations Committee (SIC and IFRIC).

The CNC made official the 2012 version of IFRS with Resolution N° 051-2012-EF/30 issued on August 29, 2012. In Peru, the CNC authorized as of December 31, 2012, current IASs 1 to 41, IFRSs 1 to 13, SICs 7 to 32 (except for superseded SICs), and all the pronouncements from 1 to 20 issued by the current Interpretations Committee (IFRIC).

(b) Basis of Measurement

The financial statements have been prepared on the historical cost basis, except for available-for-sale and held-to-maturity investments which are measured at fair value; and the retirement pension obligations which are measured at present value.

(c) Functional and Presentation Currency

Financial statements are presented in nuevos soles (S/.), according to SBS standards, which has been defined as the functional and presentation currency of the Bank. Financial information is presented in nuevos soles (S/.) and has been rounded to the nearest thousand (S/. 000), otherwise indicated.

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Notes to the Financial Statements

(d) Critical Accounting Estimates and Judgments

The accounting estimates and judgments used are reviewed on an ongoing basis and are based on experience and other factors, including the reasonable expectation of occurrence of future events depending on the circumstances.

The Bank makes estimates, judgments, and assumptions regarding the future that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. However, in the opinion of management the estimates and assumptions applied by the Bank do not have significant risk as to produce a material adjustment to the balances of assets and liabilities for next year.

The most significant accounting estimates related to the financial statements correspond to provision for loan losses and accounts receivable, valuation of investments, estimation of useful life and recoverable value of property, furniture and equipment, intangible assets, deferred income tax recovery and retirement pension provision, the accounting criteria for which is described below.

Management has exercised its critical judgment when applying accounting policies for the preparation of the accompanying financial statements, as explained in the corresponding accounting policies.

(e) Actions for Restructuring of Accounting Information of Public Sector

Law N° 29608, issued on November 4, 2010, established that the heads of public entities and companies under the scope of FONAFE (Peruvian Fund for Financing State-Owned Enterprise), will order in their respective jurisdictions the implementation of actions for the restructuring of financial information aimed at debugging the accounting information so that financial statements fairly express the economic, financial and equity reality of the entity.

The General Direction of Public Accounting of the Ministry of Economy and Finance, in compliance with Law N° 29608, has established the procedures for the accounting recording of economic facts to be regularized as a result of the actions for restructuring the operations of the public sector entities.

The General Direction of Public Accounting issued Directive N° 003-2011-EF/93.01, approved by the Directorial Resolution N° 012-2011-EF/93.01 *Basic Guidelines for the Processing of Accounting Restructuring in the Public Sector*, so that public entities establish the actual existence of goods, rights and obligations that affect equity, attesting through the appropriate information and documentation of their authenticity and existence, to begin selecting of balances of the accounts subject to debugging, so that financial statements fairly express the economic, financial and equity reality of public entities and enable reliable, consistent and timely information for the preparation of the General Account of the Republic, which is an instrument for decision making of the Government.

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Notes to the Financial Statements

By means of Circular SIED N° 27-2011, FONAFE stipulated that the Bank prepares a diagnosis on the current accounting position, in order to recognize, classify and measure the accounts that require accounting restructuring. Accordingly, the Bank's Board of Directors approved the creation of the Accounting Restructuring Committee by means of an agreement reached at Meeting N° 1861 held on June 23, 2011, to comply with Directive N° 003-2011-EF/93.01. Such committee was modified due to an agreement adopted in Directors' Meeting N° 1918 dated September 12, 2012.

By means of Directorial Resolution N° 014-2012-EF/51.01, the General of Direction Public Accounting of the Ministry of Economy and Finance establishes that August 31, 2012 is the submission date of the progress on the accounting restructuring, and March 31, 2013 is the submission date of the final results. On December 11, 2012, the Bank presented to the Accounting Restructuring Committee the final results of the accounting restructuring approved in Board of Directors' Meeting N° 1932 dated December 19, 2012.

The Bank's Accounting Restructuring Committee, in conformity with Directive N° 003-2011-EF/93.01 and the Procedure Manual for Accounting Restructuring Actions for State-Owned Enterprises, has analyzed and debugged the accounts that shall be eliminated from the balance sheet, as well as the accounts receivable that shall be written off, based on the proposals presented by the areas and ordered the debugging of certain items, subject to a report from the Department of Legal Advisory, and approval of the Bank's Board of Directors.

(3) Accounting Principles and Practices

The main accounting principles and practices applied to prepare the Bank's financial statements, which have been consistently applied with those of previous period, otherwise indicated, are the following:

(a) Financial Instruments

A financial instrument is any contract that gives rise to both a financial asset in one entity and a financial liability, or equity instrument in another.

Financial instruments are classified as assets, liabilities, or equity according to the substance of the contract. The interest, dividends, gains and losses generated by a financial instrument classified as asset or liability, are recorded as income or expense in the income statement. The financial instruments shall be offset when the Bank has the enforceable right, and management has the intention to settle on a net basis, or to realize the asset, and settle the liability simultaneously.

The financial assets and liabilities presented in the balance sheet correspond to balances of cash and due from banks, trading and held-to-maturity investments, loan portfolio, accounts receivable and liabilities in general. Likewise, indirect credits are considered financial instruments. The recognition and valuation criteria of those items are disclosed in the notes to the financial statements on accounting policies.

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Notes to the Financial Statements

(b) Investments

Criteria for initial recognition and valuation of the Bank's investments shall be applied by the Bank as established in SBS Resolution N° 10639-2008 *Regulations for Classification and Valuation of Investments of Financial System Entities*. Accordingly, the investment classification and valuation criteria are divided into four categories: (i) investments at fair value through profit or loss, (ii) available-for-sale investments, (iii) held-to-maturity investments and (iv) investments in subsidiaries and associates. The Bank classifies its investments in the following categories:

(i) Available-for-Sale Investments

Available-for-sale investments are investment instruments that are not classified as investments at fair value through profit or loss, held-to-maturity investments or investments in subsidiaries and associates.

Available-for-sale investments are initially measured at fair value plus direct costs attributable to the acquisition of such securities. The accounting value of this investment is updated at fair value and fluctuations are recognized in the equity under unrealized earnings, unless a permanent impairment in value exists. When the instrument is sold or realized, the gain or loss that was previously recognized in equity, it will be transferred and recorded to the results of the year.

(ii) Held-to-Maturity Investments

Held-to-maturity investments are debt securities that the Bank has the firm intent to hold to maturity. They are initially recorded at fair value plus any cost directly attributable to the transaction costs, and are subsequently measured at amortized cost basis using the effective interest method, less impairment losses.

In case of impairment, the carrying amount of the instrument will be reduced and the loss will be recognized to the results of the year.

(c) Loans, Classification and Provision for Doubtful Direct Loans

Direct loans are recorded as such when fund disbursements are made to clients. Indirect loans (contingent) are recorded when documents supporting the credit facilities are issued. Likewise, changes in loan payment schedules due to debtors' payment difficulties are considered refinancing or restructuring.

The Division of Loan Portfolio Evaluation of the Risks Department is in charge of conducting, on a permanent basis, the evaluation and rating of the loan portfolio, assigning to each debtor the corresponding risk rating according to the guidelines established in SBS resolution 11356-2008 and amendments.

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Notes to the Financial Statements

Loan Portfolio Classification

In conformity with SBS Resolution N° 11356-2008, and its amendments, the Bank classifies its loan portfolio in two groups: Wholesale Banking (corporate, large, and medium business loans) and Retail Banking (small and micro business loans, revolving consumer loans, non-revolving consumer loans and mortgage loans). These classifications are made considering the nature of the client (corporate, government or individual), the purpose of loan, and business size measured per revenues, indebtedness, among other indicators.

Credit Risk Rating Categories

The credit risk rating categories established by the SBS are the following: Standard, Potential Problem, Substandard, Doubtful, or Loss. Loan rating of non-retail loans portfolio (corporate, large, and medium business loans) mainly takes into account the debtor's payment capacity, cash flow, level of compliance with obligations, credit rating designated by other companies in the financial system, financial position, and management quality. In the case of retail loan portfolios (small-business loans, micro-business loans, revolving and non-revolving, and mortgage loans), the credit rating is based on the level of compliance with loan repayments, which is reflected in the arrears and in their credit rating in other entities of the financial system.

Provisions for Loan Losses

According to current SBS regulations, the Bank determines generic and specific provisions for loan portfolio. The generic provision is recorded in a preventive manner for standard risk direct loans, credit risk equivalent exposure of indirect loans, and additionally the procyclical component when the SBS orders its application. Specific provision is recorded for direct loans and credit risk equivalent exposure of indirect loans for which a specific risk, higher than standard, has been identified.

The equivalent credit risk exposure of indirect loans is determined by multiplying indirect loans by the different types of Credit Conversion Factor (CCF), as follows:

| | <u>Description</u> | <u>CCF (%)</u> |
|-------|---|----------------|
| (i) | Confirmations of irrevocable letters of credit up to one year, when the issuing bank is a first level entity from a foreign financial system | 20 |
| (ii) | Standby letters of credit that support obligations to do or not do. | 50 |
| (iii) | Issuances of guarantees, import letters of credit, and standby letters not included in subparagraph (ii) above, as well as banker's acceptances and confirmation of letters of credit not included in subparagraph (i) above. | 100 |
| (iv) | Granted loans not disbursed and unused credit lines. | 0 |
| (v) | Other indirect loans not covered by the previous paragraphs. | 100 |

Provision requirements are determined considering the debtor credit rating, whether there is a supporting guarantee, and based on the type of the established guarantees.

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In compliance with SBS Resolution N° 11356-2008, provisions for loan losses are determined applying the rates shown below:

| <u>Risk category</u> | <u>Without collateral</u> | <u>Preferred collateral</u> | <u>Easily realizable preferred collateral</u> | <u>Preferred readily realizable collateral</u> |
|------------------------------|---------------------------|-----------------------------|---|--|
| Standard | | | | |
| Corporate loans | 0.70% | 0.70% | 0.70% | 0.70% |
| Large-business loans | 0.70% | 0.70% | 0.70% | 0.70% |
| Medium-business loans | 1.00% | 1.00% | 1.00% | 1.00% |
| Small-business loans | 1.00% | 1.00% | 1.00% | 1.00% |
| Micro-business loans | 1.00% | 1.00% | 1.00% | 1.00% |
| Revolving consumer loans | 1.00% | 1.00% | 1.00% | 1.00% |
| Non-revolving consumer loans | 1.00% | 1.00% | 1.00% | 1.00% |
| Mortgage loans | 0.70% | 0.70% | 0.70% | 0.70% |
| Potential problem | 5.00% | 2.50% | 1.25% | 1.00% |
| Substandard | 25.00% | 12.50% | 6.25% | 1.00% |
| Doubtful | 60.00% | 30.00% | 15.00% | 1.00% |
| Loss | 100.00% | 60.00% | 30.00% | 1.00% |

Procyclical Component

The procyclical component to calculate provisions for direct loans and credit risk equivalent exposure of indirect loans for debtors classified as standard risk rating is established when the procyclical rule is activated. Minimum procyclical component rates per each type of loan are:

Types of LoansRates of Provision

| | |
|------------------------------|--------|
| Corporate loans | 0.40 % |
| Large-business loans | 0.45 % |
| Medium-business loans | 0.30 % |
| Small-business loans | 0.50 % |
| Micro-business loans | 0.50 % |
| Revolving consumer loans | 1.50 % |
| Non-revolving consumer loans | 1.00 % |
| Mortgage loans | 0.40 % |

For corporate, large-business, and mortgage loans that have preferred readily realizable collateral, the procyclical component rate is 0.3% for the portion covered with such collateral. For all other loans that have preferred readily realizable collateral, the procyclical component rate will be 0% for the portion covered with such collateral. For consumer loans that have contracts with discount agreements from payrolls, the procyclical component rate will be 0.25% provided that they comply with the provisions of the Resolution.

As of December 31, 2012 and 2011, the procyclical rule for the loan portfolio provisions is activated.

Provisions for direct loans are disclosed deducting the balance from the corresponding asset (note 7), and provisions for indirect loans are disclosed as liabilities (note 15).

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(d) Property, Furniture, and Equipment

Property, furniture, and equipment are recorded at acquisition cost, less accumulated depreciation and accumulated amount of any impairment suffered during their useful life (note 9). Disbursements incurred after acquisition of furniture and equipment are recognized as assets when it is probable that future economic benefits will flow to the Bank and their cost can be measured reliably. Maintenance and repair expenses are charged to results of the period they were incurred. The cost and accumulated depreciation of property, furniture and equipment disposed of or sold are eliminated from their respective accounts, and any resulting gain or loss is included in the results of the fiscal period they were incurred.

Work-in-progress and in-transit goods are recorded at acquisition cost. These goods are not depreciated until relevant assets are finished and/or received, and are in operative condition.

Land is not depreciated. Depreciation has been computed on a straight-line method basis over the following estimated useful lives:

| | <u>Years</u> |
|--|--------------|
| Buildings | 33 |
| Premises, furniture and equipment | 10 |
| Vehicles and improvements in leased properties | 5 |
| IT equipment | 4 |

Useful life and depreciation method are periodically reviewed by management according to the forecasted economic benefits to be provided by the components of property, furniture, and equipment.

(e) Impairment of Assets

When events or circumstantial economic changes indicate that the value of an asset might not be recoverable, the Bank's management reviews the value of the long-lived asset to determine if there is impairment. When the carrying amount of the asset held at cost exceeds its recoverable amount, the Bank recognizes impairment loss in the income statement.

The recoverable amount of a long-lived asset is the higher of its fair value less cost to sell and its value in use. Fair value less cost to sell of a long-lived asset is the expected amount at which an asset will be sold in a free market. Value in use is the present value of estimated future cash flows expected to arise from the continued use of an asset and from its subsequent disposal at the end of its useful life. Recoverable amounts are estimated for each asset or, if it is not possible, for the cash-generating unit.

Impairment losses recognized in previous years are reversed if there is a change in the estimates used since the last time the impairment loss was recognized.

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(f) Workers' and Pensioners' Fringe Benefits

Workers' and pensioners' fringe benefits are composed of:

(i) Profit Sharing

The Bank records a liability charged to personnel expense for workers' profit sharing based on 5% of taxable base determined according to the current tax legislation (note 26).

SBS Official Letter N° 4049-2011, dated January 21, 2011, established a change in the treatment of workers' profit sharing indicating it should be recorded according to IAS 19 *Employee Benefits*. Consequently, this profit sharing shall be considered as personnel expense and liability related to workers' benefit and can not generate deferred assets or liabilities as a result of temporary differences between financial and tax bases.

Starting January 1, 2011, workers' profit sharing shall be recognized as personnel expense; therefore, temporary differences between financial and tax bases shall not be recognized as of from that date.

(ii) Vacations and Other Benefits to Personnel

Vacations of personnel, paid leaves and other benefits of personnel are recorded on an accrual basis.

(iii) Severance Payment

The provision for severance payment (CTS) is calculated according to current legislation, on the total workers' indemnities and are paid through deposits to authorized financial system entities chosen by workers. Computation is made on the basis that it would be paid at the balance sheet date and it is included in the "Provision for fringe benefits" account. It is disclosed in the balance sheet under the "Deposits and Obligations" caption.

(iv) Retirement Pensions

The provision for retirement pensions includes mainly pension fund obligations of the Pension System by Decree Law N° 20530. In conformity with IAS 19 *Employee Benefit*, the provision for retirement pensions represents a Government Plan of Defined Benefits, in which the Bank's obligations consists on supplying benefits agreed by Decree Law N° 20530 and complementary standards. In the assumed benefits plan, the actuarial risk is assumed by the Bank and supported by its assets and operations. Based on life expectations of the beneficiaries of this system, it is estimated that the amount of this obligation will be reduced progressively on a long-term basis.

The provision for the retirement reserve fund of the working and retired personnel is recorded according to Supreme Decree N° 043-2003-EF published on March 28, 2003, which states that State companies will be governed by Accounting Resolution N° 159-2003-EF/93.01 published on March 12, 2003, which approved the Chart of Accounts 20-2003-EF/93.01 that establishes the accounting procedure for the recording and control of pension reserves, non pension reserves and reserves for contingencies.

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The Bank fully records the result of actuarial calculations for pension reserves as liability. The total amount of pension fund obligations is adjusted based on the amounts obtained from future actuarial calculations and resulting variance is directly recorded to results of corresponding period.

The actuarial calculation of pension fund obligations is made annually by a competent actuary of the Planning, Statistics and Rationalization Division of the Social Security Administration Office (hereinafter ONP) using the technical guide of the ONP approved by Resolution N° 227-2009-Jefatura/ONP dated December 4, 2009. The value of the pension determined according to the actuarial calculation is measured at present value of all future payments of pensions using a discount rate of 4.5% since financial instruments owned by the Bank assure profitability rates exceeding 4% (annual technical interest rate-TITA, for its Spanish acronym) for a medium and long-term horizon.

(g) Income Tax

Current income tax is determined based on the taxable income and is recorded according to tax legislation applicable to the Bank (note 27).

Deferred income tax is recorded using the liability method based on temporary differences derived from tax accounting of assets and liabilities, and their balances in the financial statements. Deferred income tax is determined based on current tax rates and legislation expected to be applied when the deferred income tax asset is realized or the deferred income tax liability is settled (note 10).

Deferred income tax assets and liabilities are recorded without considering the estimated time the temporary differences will disappear. Deferred income tax asset is only recognized to the extent that it is longer probable that sufficient taxable profit will be available against which deductible temporary differences can be offset.

(h) Provisions and Contingencies

(i) Provisions

Provisions are recognized when the Bank has a present obligation, either legal or constructive, as a result of past events, and when it is probable that an outflow of resources will be required to settle the obligation, and it is possible to reliably estimate its amount. Provisions are reviewed and adjusted in each period to reflect the higher estimates as of the balance sheet date.

(ii) Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed in the notes to the financial statements, unless the possibility of an outflow of economic resources is remote.

Contingent assets are not recorded in financial statements, and they are only disclosed when an inflow of economic benefits is probable.

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Notes to the Financial Statements

(i) Income and Expense Recognition

Interest income and expenses are recognized in the corresponding fiscal year on accrual basis, depending on the term of the generating transactions and the interest rate agreed with the clients. Commissions for banking services are recognized as income when earned.

If management considers there are reasonable doubts with collectibility of the principal of a loan, the Bank suspends the recognition of interest in the profit or loss. Interest in suspense is recorded in memoranda accounts and recognized as earned when collected. When management considers that the financial situation of the debtor has improved and the doubt about the collectibility of the principal has been dissipated, the recording on accrual basis is restated.

Interest income includes the return on fixed-income investments and trading securities, as well as the recognition of discounts and premiums on financial instruments. Dividends are recorded as income when declared.

Bank's other income and expenses are recorded in the period they are accrued.

(j) Statement of Cash Flows

The Bank considers the balance of cash and due from banks of the balance sheet as cash and cash equivalents.

(k) Trustee Activities

Assets and cash flows from trust operations, where there is an engagement to return these assets and flows to the clients and the Bank acts as trustee, are not included in the financial statements since they do not belong to the Bank but are recorded in memoranda accounts for their corresponding control.

(l) Foreign Currency Transactions and Balances

Foreign currency transactions are those transactions carried out in a currency other than nuevo sol. Foreign currency transactions are translated into nuevo sol using exchange rates established by the SBS and reported at the dates of the transactions (note 4). Gains or losses from foreign exchange differences resulting from the payment of such transactions and from the translation of monetary assets and liabilities stated in foreign currency at exchange rates reported at the closing of the period are recognized in the income statement.

(m) New Accounting Pronouncements Not Adopted

(i) The following standards and interpretations have been published for application to periods beginning after these financial statement presentation date.

- IFRS 9 *Financial Instruments* modifies the treatment and classification of financial assets established in IAS 39 *Financial Instruments: Recognition and Measurement*. Effective for annual periods beginning on or after January 1, 2015.

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- IFRS 13 *Fair Value Measurement* establishes the new fair value measurement requirements, improves the coherence of the international standards, and reduces complexity, providing a definition of a fair value and a source for its measurement, as well as the disclosure requirements for its use through IFRSs. Effective for annual periods beginning on or after January 1, 2013.
- IAS 19 *Post-Employment Benefits*, it will improve the conditions for recognition and disclosure of a defined benefit plan. Effective for annual periods beginning on or after January 1, 2013.
- Amendments to IFRS
The following standards have been amended:
IAS 1 - *Presentation of items of other comprehensive income*
IAS 32 - *Offsetting financial assets and financial liabilities*
IFRS - Annual Improvements to IFRSs 2009-2011 Cycle (IAS 16, IAS 32 and IAS 12)

SBS Resolution N° 914-2010 extended the application of IFRS 7 *Financial Instruments: Disclosures* and IFRS 8 *Operating Segments*. This postponement is effective until the SBS issue corresponding regulation as part of the process to harmonize its accounting regulations to IFRS.

As indicated in note 2a, the IFRS and IFRIC will only be applicable to the Bank, in absence of applicable SBS regulations for situations not covered in the Accounting Manual. The Bank's management has not determined the effect on the preparation of its financial statements in case such standards were adopted by the SBS.

(ii) SBS Pronouncements with accounting effect:

- On September 19, 2012, the SBS issued Resolution N° 7036-2012, establishing that entities under its supervision shall prepare and present its financial statements applying the new accounting policies harmonized to IFRS, except in those cases where the SBS has defined prudential treatment approved for financial entities. Such accounting policies have been approved and included in the Accounting Manual and became applicable to financial information corresponding to January 2013. By means of Official Letter N° 45311-2012-SBS, dated November 30, 2012, the SBS established a term of adaptation until May 31, 2013 concerning specific changes in the Accounting Manual in conformity with Annexes 1 and 2 of SBS Resolution N° 7036-2012.

In December 2012, the Bank presented to SBS its IFRS implementation Plan in accordance with SBS Resolution N° 7036-2012, which contains the schedule of activities for the accounting and IT system adaptation. This implementation plan was approved by Board of Directors' Meeting held on December 12, 2012.

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- SBS Resolution N° 7033-2012, approved the new *Regulations for the Classification and Valuation of Investments of Financial System Entities*, considering it convenient to harmonize the accounting regulations to IFRS. Effective as from January 2013.

(4) Foreign Currency Balances

The balance sheets include balances of foreign currency transactions, mainly in U.S. dollars (US\$), which are recorded in nuevos soles (S/.) at the exchange rate established by the SBS. As of December 31, 2012 and 2011, these rates were US\$1 = S/. 2.550 and S/. 2.696, respectively.

Foreign currency transactions in the country and international trade transactions referred to the concepts authorized by Central Reserve Bank of Peru - BCRP (Central Bank), are channeled through an interbank foreign exchange market. As of December 31, 2012, the buy and sell exchange rates used were US\$ 1 = S/. 2.549 and US\$ 1 = S/. 2.551, respectively (US\$ 1 = S/. 2.695 and US\$ 1 = S/. 2.697, the buy and sell rates, respectively as of December 31, 2011).

Foreign currency balances stated in thousands of U.S. dollars as of December 31, are summarized as follows:

| | <u>In thousands of US\$</u> | |
|---|-----------------------------|---------------------|
| | <u>2012</u> | <u>2011</u> |
| Assets: | | |
| Cash and due from banks | 385,518 | 750,902 |
| Trading and held-to-maturity investments | 201,038 | 114,584 |
| Loan portfolio | 122,739 | 73,108 |
| Accounts receivable | 93,294 | 103,218 |
| Other assets | 3,115 | 4,368 |
| | <u>805,704</u> | <u>1,046,180</u> |
| Liabilities: | | |
| Deposits and obligations | (702,614) | (924,643) |
| Deposits in financial system enterprises and international financial entities | (100,893) | (100,313) |
| Accounts payable | (272) | (1,054) |
| Other liabilities | (18,885) | (11,000) |
| | <u>(822,664)</u> | <u>(1,037,010)</u> |
| Net (liability) asset position | <u>(16,960)</u> | <u>9,170</u> |

As of December 31, 2012, the Bank has contingent operations in foreign currency amounting to US\$ 182,407 thousand, equivalent to S/. 465,138 thousand (US\$ 235,947 thousand equivalent to S/. 636,113 thousand as of December 31, 2011).

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(5) Cash and Due from Banks

It comprises the following:

| | <u>In thousands of S/.</u> | |
|--|----------------------------|-------------------|
| | <u>2012</u> | <u>2011</u> |
| Cash: | | |
| Main office | 497,637 | 319,668 |
| Branches and agencies | 306,141 | 280,755 |
| Other locations | 113,157 | 143,533 |
| Cash in transit | 217,549 | 14,552 |
| Gold and silver minted in bars | 329 | 329 |
| | ----- | ----- |
| | 1,134,813 | 758,837 |
| | ----- | ----- |
| Central Reserve Bank of Peru: | | |
| Ordinary account | 2,554,681 | 1,595,181 |
| Special account | 5,230,441 | 9,157,093 |
| Overnight deposits | 433,500 | 1,577,160 |
| Time deposits | 3,008,000 | 14,095 |
| | ----- | ----- |
| | 11,226,622 | 12,343,529 |
| | ----- | ----- |
| Banks and other entities of the local financial system | 20,842 | 20,605 |
| Banks and other entities of foreign financial system | 242,739 | 148,953 |
| Clearing account | 44,170 | 74,183 |
| Accrued interest and due from banks and others | 48,823 | 27,654 |
| | ----- | ----- |
| | <u>12,718,009</u> | <u>13,373,761</u> |

As of December 31, 2012, they include US\$ 112,594 thousand and S/. 3,204,452 thousand (US\$ 98,510 thousand and S/. 2,062,313 thousand as of December 31, 2011) that are assigned to cover legal cash reserve that the Bank must set aside to cover deposits from third parties, according to limits established by current legislation. These funds are held both at Banco Central de Reserva del Perú (BCRP) and at the Bank's vault.

Legal cash reserve funds held at BCRP do not accrue interest except for the required amount in foreign currency and local currency that exceeds the minimum legal cash reserve. As of December 31, 2012, the excess of minimum legal cash reserve in foreign currency and local currency accrue an annual interest rate of 0.11% and 1.70%, respectively (annual interest rate of 0.17% and 2.45%, respectively, as of December 31, 2011).

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As of December 31, 2012 and 2011, "overnight" transactions deposited at BCRP, amounted to US\$ 170,000 thousand and US\$ 585,000 thousand, respectively.

Deposits in local and foreign banks correspond, mainly, to balances in nuevos soles and in U.S. dollars, and minor amounts in other currencies, with free withdrawal option and accrue interest at market rates.

In 2012, interest on cash and due from banks amounted to S/. 316,535 thousand (S/. 306,502 thousand in 2011) and is included under the interest income caption in the income statement (note 20).

(6) Trading and Held-to-Maturity Investments
They comprise the following:

| | <u>In thousands of S/.</u> | |
|---|----------------------------|-------------|
| | <u>2012</u> | <u>2011</u> |
| <u>Available-for-sale investments</u> | | |
| Securities and bonds issued by the Peruvian government: | | |
| BCRP certificates of deposit (a) | 1,883,707 | 241,122 |
| Sovereign bonds (b) | 675,111 | 748,149 |
| Global bonds (b) | 293,128 | 210,841 |
| | ----- | ----- |
| | 2,851,946 | 1,200,112 |
| Accrued interest | 36,523 | 17,381 |
| | ----- | ----- |
| | 2,888,469 | 1,217,493 |
| | ----- | ----- |
| Securities and bonds issued by other firms: | | |
| Corporate bonds (c) | 257,858 | 131,862 |
| Shares | 24,312 | 19,463 |
| Commercial papers | 7,966 | 4,469 |
| Securitized bonds | 6,933 | 8,111 |
| Certificates of marketable deposits | 4,985 | 7,153 |
| Financial lease bonds | 325 | 5,396 |
| | ----- | ----- |
| | 302,379 | 176,454 |
| Accrued interest | 2,455 | 1,657 |
| | ----- | ----- |
| | 304,834 | 178,111 |
| | ----- | ----- |
| | 3,193,303 | 1,395,604 |
| | ----- | ----- |
| <u>Held-to-maturity investments</u> | | |
| Peru Public Treasury Bonds | | |
| S.D. N° 002-2007 Bond (d) | 1,745,722 | 1,889,890 |
| | ----- | ----- |
| | 1,745,722 | 1,889,890 |
| | ----- | ----- |
| | 4,939,025 | 3,285,494 |
| | ===== | ===== |

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- (a) BCRP certificates of deposit are bearer securities freely negotiable; they have current maturity and were acquired through public bids of BCRP and marketed in the Peruvian secondary market. As of December 31, 2012, internal rates of return in local currency range from 3.80% to 4.17% being interest rates for each bid determined by the BCRP.
- (b) Sovereign and global bonds have been acquired at rates and prices offered in the market as of the date of the negotiation. As of December 31, 2012, sovereign bonds generate returns at annual interest rates in local currency that range from 4.19 % to 5.59 % (between 4.25% and 6.59% as of December 31, 2011) and mature between 2013 and 2042. Likewise, global bonds at the end of the period generate returns with an internal rate of return that range from 0.59% to 3.98 % (from 1.95% to 4.86% in 2011) and mature between 2013 and 2050.
- (c) Corporate bonds correspond to instruments acquired from first-level companies. As of December 31, 2012, annual interest rates range from 0.05% to 6.29% (as of December 31, 2011, from 0.16% to 8.08%).
- (d) As of December 31, 2012 and 2011, held-to-maturity investments comprise the Supreme Decree N° 002-2007 Bond issued by the MEF for the compensation and consolidation of reciprocal debts between this entity and the Bank (note 1). Such bond accrues interest at an annual internal rate of return of 6.3824%, is payable quarterly and is amortized on an annual basis with a 30-year maturity. In 2012, the bond generated interest for S/. 111,117 thousand (S/. 120,556 thousand in 2011), recorded in the revenues from trading and held-to-maturity investments item of the income statement.

At Board of Directors' Meeting N° 1895 held on March 21, 2012, the Board approved the distribution of the Bank's 2011 net profits to the Public Treasury. Consequently, the Supreme Decree N° 002-2007-EF Bond was amortized in the amount of S/. 143,786 thousand as a result of such distribution (note 17c).

Securities and bonds issued by other entities as of December 31, are distributed in the following economic sectors:

| | In thousands of S/. | | In % | |
|-----------------------------|---------------------|---------|-------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Financial companies | 141,823 | 104,423 | 46 | 59 |
| Manufacturing companies | 91,111 | 25,361 | 30 | 14 |
| Energy companies | 48,747 | 22,470 | 16 | 13 |
| Telecommunication companies | 20,698 | 24,200 | 7 | 13 |
| | ----- | ----- | ----- | ----- |
| | 302,379 | 176,454 | 99 | 99 |
| Accrued interest | 2,455 | 1,657 | 1 | 1 |
| | ----- | ----- | ----- | ----- |
| | 304,834 | 178,111 | 100 | 100 |
| | ===== | ===== | ===== | ===== |

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As of December 31, 2012 and 2011, the accrued interest on available-for-sale, and held-to-maturity investments amounted to approximately S/. 199,594 thousand and S/. 181,290 thousand, respectively, and are included under the interest income caption in the income statement (note 20).

Available-for-sale and held-to-maturity investments as of December 31, 2012 and 2011 have the following maturities:

| | In thousands of S/. | |
|---------------------------|---------------------|------------------|
| | 2012 | 2011 |
| Up to 3 months | 181,161 | 102,053 |
| 3 months - 1 year | 1,496,545 | 313,403 |
| 1 - 3 years | 423,828 | 32,838 |
| 3 - 5 years | 278,391 | 163,119 |
| More than 5 years | 2,534,446 | 2,654,457 |
| Without maturity (shares) | 24,654 | 19,624 |
| | <u>4,939,025</u> | <u>3,285,494</u> |

- (7) Loan Portfolio, Net
They comprise the following:

| | In thousands of S/. | | | |
|--|---------------------|------------|------------------|------------|
| | 2012 | % | 2011 | % |
| Direct loans | | | | |
| Current | 5,696,003 | 102 | 5,055,566 | 102 |
| Refinanced | 381 | - | 305 | - |
| Overdue | 15,166 | - | 19,857 | - |
| Loans in legal collection | 18,874 | - | 47,164 | 1 |
| | <u>5,730,424</u> | <u>102</u> | <u>5,122,892</u> | <u>103</u> |
| Income from deferred interest on refinanced loans | (135) | - | (97) | - |
| Accrued interest on current loans | 32,295 | 1 | 40,172 | 1 |
| Provision for doubtful loans | (175,159) | (3) | (197,781) | (4) |
| Total direct loans, net | <u>5,587,425</u> | <u>100</u> | <u>4,965,186</u> | <u>100</u> |
| Indirect loans (note 19) | <u>530,776</u> | | <u>671,343</u> | |

Loan portfolio (direct and indirect) is guaranteed with collaterals received from clients, most of them state pensioners, workers from governmental organisms or governmental organisms that hold deposits at the Bank.

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As of December 31, annual average effective interest rates for the following main products were as follows:

| | % | | | |
|-----------------|-------------------|---------------------|-------------------|---------------------|
| | 2012 | | 2011 | |
| | Local currency | Foreign currency | Local currency | Foreign currency |
| Overdrafts | 7 - 17 | 12 | 7 - 17 | 12 |
| Corporate loans | 7 - 13 | 8 | 7 - 13 | 8 |
| Consumer loans | 10 - 19 | - | 13 - 19 | - |
| Mortgage loans | 7 - 10 | - | 8 - 9 | - |

As of December 31, according to current SBS regulations, the Bank's loan portfolio is risk rated as follows:

| Risk Rating | 2012 | | | | | | | | 2011 | | | | | | | |
|----------------------|----------------------|-----|---------------------|-----|----------|-----|-----------|-----|----------------------|-----|---------------------|-----|----------|-----|-----------|-----|
| | Number of debtors | % | In thousands of S/. | | | | Total | % | Number of debtors | % | In thousands of S/. | | | | | |
| | | | Direct | % | Indirect | % | | | | | Direct | % | Indirect | % | Total | % |
| Standard | 500,425 | 94 | 5,624,019 | 98 | 458,120 | 86 | 6,082,139 | 97 | 513,815 | 95 | 4,980,878 | 97 | 671,343 | 100 | 5,652,221 | 98 |
| Potential problem | 3,225 | 1 | 17,975 | - | - | - | 17,975 | - | 3,605 | 1 | 24,703 | 1 | - | - | 24,703 | - |
| Substandard | 3,654 | 1 | 15,197 | - | - | - | 15,197 | - | 4,661 | 1 | 18,184 | - | - | - | 18,184 | - |
| Doubtful | 14,820 | 3 | 42,355 | 1 | 72,656 | 14 | 115,011 | 3 | 12,105 | 2 | 34,821 | 1 | - | - | 34,821 | 1 |
| Loss | 5,138 | 1 | 30,878 | 1 | - | - | 30,878 | - | 5,796 | 1 | 64,306 | 1 | - | - | 64,306 | 1 |
| | 527,262 | 100 | 5,730,424 | 100 | 530,776 | 100 | 6,261,200 | 100 | 539,982 | 100 | 5,122,892 | 100 | 671,343 | 100 | 5,794,235 | 100 |

As of December 31, direct loans are distributed among economic sectors as follows:

| | In thousands of S/. | | | |
|---|---------------------|-----|-----------|-----|
| | 2012 | % | 2011 | % |
| Consumer loans | 2,853,895 | 50 | 2,834,243 | 55 |
| Public administration and defence | 1,896,671 | 33 | 1,582,736 | 31 |
| Financial intermediation | 809,139 | 14 | 300,058 | 6 |
| Mining | 91,800 | 2 | - | - |
| Mortgage loans | 72,486 | 1 | 47,915 | 1 |
| Transportation, warehousing and communications | 2,976 | - | 1,738 | - |
| Other community service activities | 1,826 | - | 149,268 | 3 |
| Manufacturing | 1,568 | - | 199,240 | 4 |
| Other | 51 | - | 1,821 | - |
| Trade | 12 | - | 5,873 | - |
| | 5,730,424 | 100 | 5,122,892 | 100 |

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Direct loans have the following contractual maturities as of December 31:

| | In thousands of S/. | |
|-------------------|---------------------|-----------|
| | 2012 | 2011 |
| Up to 1 month | 219,945 | 221,342 |
| 1 - 6 months | 867,896 | 978,174 |
| 6 months - 1 year | 1,021,152 | 681,295 |
| More than 1 year | 3,478,568 | 3,084,375 |
| | 5,587,561 | 4,965,186 |
| | 5,587,561 | 4,965,186 |

The activity of the provision for doubtful direct loans is as follows:

| | In thousands of S/. | | |
|---------------------------------|---------------------|-----------|-----------|
| | Specific | Generic | Total |
| Balance as of January 31, 2011 | 82,522 | 118,078 | 200,600 |
| Additions debited to results | 10,580 | 12,417 | 22,997 |
| Foreign exchange difference | (1,274) | (144) | (1,418) |
| Recovery of provisions | (98) | (23,536) | (23,634) |
| Write-off and transfers | (764) | - | (764) |
| Balance as of December 31, 2011 | 90,966 | 106,815 | 197,781 |
| Additions debited to results | 13,703 | 8,746 | 22,449 |
| Foreign exchange difference | (452) | (304) | (756) |
| Recovery of provisions | (396) | (1,049) | (1,445) |
| Write-off and transfers | (42,870) | - | (42,870) |
| Balance as of December 31, 2012 | 60,951 | 114,208 | 175,159 |
| | 60,951 | 114,208 | 175,159 |

As of December 31, the generic provision comprises the following:

| | In thousands of S/. | |
|--|---------------------|---------|
| | 2012 | 2011 |
| Procyclical provision | 39,026 | 36,352 |
| Provision for debt over credit leverage risk of retail debtors | 27,546 | 27,381 |
| Others | 47,636 | 43,082 |
| | 114,208 | 106,815 |
| | 114,208 | 106,815 |

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The Bank records the potential losses of its loan portfolio according to the policy described in note 3(c).

In management's opinion, the loan provision, recorded as of December 31, 2012 and 2011, meets SBS regulations in force at those dates.

- (8) Accounts Receivable, Net
They comprise the following:

| | <u>In thousands of S/.</u> | |
|-------------------------------------|----------------------------|----------------|
| | <u>2012</u> | <u>2011</u> |
| Accounts receivable from Cofide (a) | 250,000 | 264,314 |
| Other accounts receivable | 67,981 | 98,606 |
| | ----- | ----- |
| | 317,981 | 362,920 |
| Provision for doubtful accounts (b) | (34,741) | (25,305) |
| | ----- | ----- |
| | <u>283,240</u> | <u>337,615</u> |

- (a) Emergency Decree N° 024-2009 of February 19, 2009, established the creation of the trust called Business Guarantee Fund -- FOGEM for up to an amount of S/. 300,000 thousand; the objective of the trust was to guarantee loans that the entities of the National Financial System grant to micro and small productive, service and trade companies, as well as to medium-size companies that are engaged in the production and/or services within the non-traditional export chains.

Based on this emergency decree, the Bank was authorized to contribute to the FOGEM, as Trustee, with S/. 300,000 thousand.

FOGEM is managed in Trust by Corporación Financiera de Desarrollo S.A. (Cofide), under the terms and conditions of the contract entered into by both entities.

The term to use the FOGEM was 2 years counted from the effective date of the operating regulations; however, by means of Emergency Decree N° 058-2011 dated October 26, 2011, the term was extended to September 30, 2012; and by means of Emergency Decree N° 016-2012 dated June 25, 2012, term was extended again to December 31, 2012.

As of December 31, 2012 and 2011, accounts receivable from Cofide correspond to the amount transferred to FOGEM amounting to US\$ 98,039 thousand (equivalent to S/. 250,000 thousand as of December 31, 2012, and S/. 264,314 thousand as of December 31, 2011).

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(b) The activity of the provision for doubtful accounts receivable is as follows:

| | In thousands of S/. | |
|------------------------------|---------------------|-----------|
| | 2012 | 2011 |
| Balance as of January 1 | 25,305 | 27,017 |
| Additions debited to results | 14,221 | 10,658 |
| Others, net | (4,785) | (12,370) |
| Balance as of December 31 | 34,741 | 25,305 |

(9) Properties, Furniture, and Equipment, Net
They comprise the following:

Year 2012:

| | In thousands of S/. | | | | | Balances as of 12.31.2012 |
|---|------------------------------|-----------|-----------|-----------|-------------|------------------------------|
| | Balances as of 12.31.2011 | Additions | Disposals | Transfers | Adjustments | |
| Cost: | | | | | | |
| Land | 54,428 | 276 | - | 85 | 6 | 54,795 |
| Buildings and premises | 380,295 | - | - | 14,260 | 60 | 394,615 |
| Furniture and equipment | 88,536 | 2,864 | (574) | 2,213 | (92) | 92,947 |
| IT equipment | 131,381 | 13,939 | (105) | 2 | 454 | 145,671 |
| Vehicles | 6,935 | - | - | - | - | 6,935 |
| Work-in-progress | 41,609 | 4,184 | - | (21,607) | (2,106) | 22,080 |
| Goods in transit | 5,791 | 24,781 | - | (979) | (4,912) | 24,681 |
| Premises and improvements in leased properties | 22,276 | - | - | 6,026 | (20,431) | 7,871 |
| | 731,251 | 46,044 | (679) | - | (27,021) | 749,595 |
| Depreciation: | | | | | | |
| Buildings and premises | 228,560 | 11,857 | (6) | - | 440 | 240,851 |
| Furniture and equipment | 45,645 | 7,344 | (503) | - | 140 | 52,626 |
| IT equipment | 90,074 | 17,851 | (104) | - | - | 107,821 |
| Vehicles | 5,761 | 397 | - | - | - | 6,158 |
| Premises and improvements in leased properties | 16,597 | 1,364 | (19,588) | - | 5,671 | 4,044 |
| | 386,637 | 38,813 | (20,201) | - | 6,251 | 411,500 |
| Less, impairment of property | 41,131 | - | - | - | - | 41,131 |
| | 303,483 | | | | | 296,964 |

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Year 2011:

| | In thousands of S/. | | | | | Balances as of 12.31.2011 |
|---|------------------------------|-----------|-----------|-----------|-------------|------------------------------|
| | Balances as of 12.31.2010 | Additions | Disposals | Transfers | Adjustments | |
| Cost: | | | | | | |
| Land | 54,428 | - | - | - | - | 54,428 |
| Buildings and premises | 369,392 | - | - | 11,199 | (296) | 380,295 |
| Furniture and equipment | 84,912 | 3,306 | (544) | 878 | (16) | 88,536 |
| IT equipment | 115,794 | 19,072 | (4,110) | 630 | (5) | 131,381 |
| Vehicles | 6,843 | - | - | - | 92 | 6,935 |
| Work-in-progress | 44,763 | 15,536 | - | (15,415) | (3,275) | 41,609 |
| Goods in transit | 4,968 | 2,561 | - | (599) | (1,139) | 5,791 |
| Premises and improvements in leased properties | 19,801 | - | - | 3,307 | (832) | 22,276 |
| | 700,901 | 40,475 | (4,654) | - | (5,471) | 731,251 |
| Depreciation: | | | | | | |
| Buildings and premises | 216,489 | 12,085 | - | - | (14) | 228,560 |
| Furniture and equipment | 38,857 | 6,804 | (434) | - | (4) | 45,645 |
| IT equipment | 79,582 | 14,593 | (4,101) | - | - | 90,074 |
| Vehicles | 5,101 | 660 | - | - | - | 5,761 |
| Premises and improvements in leased properties | 14,410 | 2,187 | - | - | - | 16,597 |
| | 354,439 | 36,751 | (4,535) | - | (18) | 386,637 |
| Less, impairment of property | 41,131 | - | - | - | - | 41,131 |
| | 305,331 | | | | | 303,483 |

According to current legislation, banks in Peru are not allowed to place as guarantee the component items that are part of their properties, furniture, and equipment, except for those acquired through the issuance of leasing bonds to carry out finance lease operations.

(10) Deferred Income Tax

The Bank applied the liability methodology for the determination of the deferred income tax as of December 31, 2012 and 2011 following the revised IAS 12.

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The activity in the net assets for deferred income tax and their originating items were as follows:

| | In thousands of S/. | | | | Balance as of 12.31.2012 |
|---|------------------------------|------------|-----------|----------|-----------------------------|
| | Balances as of 12.31.2011 | Adjustment | Equity | Results | |
| Temporary differences: | | | | | |
| Asset | | | | | |
| Provision for litigations and claims | 39,554 | - | - | (9,799) | 29,755 |
| Generic provision for direct doubtful loans | 32,044 | - | - | 2,218 | 34,262 |
| Provision for impairment of property | 9,746 | - | - | - | 9,746 |
| Provision for vacations | 5,623 | - | - | 240 | 5,863 |
| Generic provision for contingent loans | 2,112 | - | - | (632) | 1,480 |
| Specific provision for contingent loans | - | - | - | 218 | 218 |
| Other | 3,634 | 263 | - | 1,436 | 5,333 |
| Liability | | | | | |
| Unrealized results | (2,774) | - | (18,165) | - | (20,939) |
| Property depreciation | (1,366) | (759) | - | 759 | (1,366) |
| Total deferred asset | 88,573 | (496) | (18,165) | (5,560) | 64,352 |

In 2012, the charge to results for deferred income tax, amounted to S/. 5,560 thousand (credit for S/. 10,799 thousand in 2011).

As of December 31, 2012 and 2011, the Bank discloses the deferred income tax generated from the unrealized results of available-for-sale investments, net of such item.

(11) Other Assets, Net

They comprise the following:

| | In thousands of S/. | |
|---|---------------------|---------|
| | 2012 | 2011 |
| Tax credit (a) | 99,949 | 61,318 |
| Income tax partial payments | 82,550 | 95,216 |
| Head office and branches (b) | 41,618 | 26,572 |
| Transactions in progress (c) | 34,033 | 85,724 |
| Intangible assets, net of amortization of S/. 53,936 thousand and S/. 22,089 thousand, respectively | 20,932 | 16,619 |
| Prepaid and deferred charges | 9,617 | 7,647 |
| Sundry assets | 1,464 | 989 |
| | 290,163 | 294,085 |

- (a) The tax credit balance includes the ITAN paid in fiscal period 2012 amounting to S/. 31,985 thousand; the tax withheld by Cofide for the management of FOGEM for S/. 1,915 thousand; and credit for income tax for previous years for S/. 66,049 thousand.

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- (b) The Head Office and branches balance corresponds to pending transactions between the Bank's offices located across the nation, being the main type of transaction the cash remittances transferred from the Head Office through the Central Reserve Bank of Peru to agencies and offices in provinces.
- (c) Transactions in progress are those carried out during the last days of one month and are reclassified in the following month under their respective accounts in the balance sheet; these transactions do not affect the Bank's results. As of December 31, 2012, they comprise S/. 23,846 thousand corresponding to operations payable for debit outstanding accounts, which were transferred to their corresponding accounts in January 2013 (S/. 57,420 thousand as of December 31, 2011).

(12) Deposits and Obligations

They comprise the following:

| | <u>In thousands of S/.</u> | |
|---------------------------------|----------------------------|-------------------|
| | <u>2012</u> | <u>2011</u> |
| Demand deposits (a) | 12,214,737 | 11,774,418 |
| Savings deposits (b) | 4,358,552 | 3,860,512 |
| Time deposits (c) | 309,082 | 351,714 |
| Other obligations (d) | 4,370,858 | 3,957,298 |
| Expenses payable on obligations | 85,655 | 86,200 |
| | <u>21,338,884</u> | <u>20,030,142</u> |

- (a) Demand deposits are composed as follows:

| | <u>In thousands of S/.</u> | |
|-------------------------------|----------------------------|-------------------|
| | <u>2012</u> | <u>2011</u> |
| Deposits in checking accounts | 12,052,323 | 11,590,610 |
| Certified checks | 16,111 | 21,210 |
| Cashier's checks | 95,101 | 114,728 |
| Transfers payable | 51,150 | 47,780 |
| Collections payable | 52 | 90 |
| | <u>12,214,737</u> | <u>11,774,418</u> |

Deposits in checking accounts mainly correspond to: i) Private companies for about S/. 2,769,320 thousand and US\$ 3,362 thousand (S/. 2,101,286 thousand and US\$ 40,889 thousand in year 2011); ii) local governments for about S/. 1,409,699 thousand and US\$ 1,895 thousand (S/. 1,383,541 thousand and US\$ 1,951 thousand in year 2011); iii) regional governments for about S/. 1,259,476 thousand and US\$ 29,964 thousand (S/. 1,351,961 thousand and US\$ 8,712 thousand in year 2011); iv) Ministry of Economy and Finance for about S/. 850,960 thousand and US\$ 22,353 thousand (S/. 924,738 thousand and US\$ 32,244 thousand in year 2011);

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- v) Prime Minister's Office for about S/. 2,831 thousand and US\$ 1,235 thousand (S/. 6,116 thousand and US\$ 204,114 thousand in year 2011); vi) Cofide for about S/. 3,757 thousand and US\$ 90,491 thousand (S/. 12,706 thousand and US\$ 92,717 thousand in year 2011). Such deposits represent approximately 55% of deposits in checking accounts as of December 31, 2012 (57% as of December 31, 2011).
- (b) Saving deposits correspond to accounts opened to pay salaries and pensions of public sector workers.
- (c) Time deposits include bank certificates, time deposits and severance payment (CTS) deposits for S/. 3,664 thousand, S/. 241,600 thousand and S/. 63,818 thousand, respectively (S/. 3,764 thousand, S/. 284,720 thousand and S/. 63,230 thousand, respectively as of December 31, 2011).

The annual effective interest rate established for saving and time deposits in force for 2012 was 0.20% to 0.90% in local currency (0.40% to 1.80% in year 2011) and 0.09% to 0.40% in foreign currency (0.09% to 0.40% in 2011).

- (d) Balances of other obligations comprise the following:

| | In thousands of S/. | |
|--|---------------------|-----------|
| | 2012 | 2011 |
| Tax collection agencies | 250,496 | 192,640 |
| Restricted deposits and obligations | 2,022,467 | 1,586,529 |
| Workers' and pensioners' fringe benefits | 2,097,895 | 2,178,129 |
| | ----- | ----- |
| | 4,370,858 | 3,957,298 |
| | ===== | ===== |

Workers' and pensioners' fringe benefits

Provision for fringe benefits comprises obligations for indemnities of active workers; as well as provision for retirement of former workers and active workers of the Bank, subject to the pension regime of Law Decree N° 20530. As of December 31, they comprise the following:

| | In thousands of S/. | |
|------------------------------------|---------------------|-----------|
| | 2012 | 2011 |
| Law N° 4916 Labor Regime | 3,695 | 3,953 |
| D. L. N° 11377 Labor Regime | 139 | 144 |
| D. L. N° 20530 Retirement Pensions | 2,094,061 | 2,174,032 |
| | ----- | ----- |
| | 2,097,895 | 2,178,129 |
| | ===== | ===== |

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D.L. N° 20530 - Retirement Pensions

Retirement pensions principally correspond to the present value of future pension payments to active and former Bank's workers under the framework of Decree Law N° 20530.

They comprise life annuity received by pensioners for severance pay, disability, widows' and orphans' pension funds. Pension fund transactions have been traditionally considered among the actuarial operations of life; however, it has specific characteristics, economic importance and requires actuarial specialization. Considering the particularities of the social pension fund operations, those are defined as operations where the potential period for risk coverage is the whole life of the insured individual.

Supreme Decree N° 043-2003-EF was published on March 28, 2003, introducing rules on registration of pension fund obligations under the pension scheme provided by Decree Law N° 20530 and amendments, not financed with Treasury funds. This decree amended Supreme Decree N° 106-2002-EF, by including the rules contained in Supreme Decree N° 026-2003-EF of February 27, 2003, in the actuarial calculation for pensions and, as applicable, those of Accounting Resolution N° 159-2003-EF/93.01 of March 6, 2003 and other provisions adopted by the Peruvian Board of Public Accountancy for the purposes of registration and control of pension obligations.

Under article 2° of Supreme Decree N° 043-2003-EF, Fonafe will issue regulatory provisions governing the constitution of funds necessary to finance the retirement pension obligations of entities and companies under its scope. The Bank does not have assets belonging to the pension plan as of the balance sheet date.

The activity of the retirement pensions account is as follows:

| | In thousands of S/. | |
|--|---------------------|------------------|
| | 2012 | 2011 |
| Balance at beginning of year | 2,174,032 | 2,180,656 |
| Increase debited to results (note 23) | 104,801 | 186,278 |
| Provisions, installments and widows' and orphans' pension fund | 3,834 | 3,998 |
| Payment to pensioners | (188,606) | (196,900) |
| Balance at end of year | <u>2,094,061</u> | <u>2,174,032</u> |

The liability for retirement pensions decreased compared to 2011, mainly due to decrease in the number of pensioners from 6,083 as of December 31, 2011 to 5,943 pensioners as of December 31, 2012.

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Actuarial Assumptions

The main actuarial assumptions as of the balance sheet date are:

| | <u>2012</u> | <u>2011</u> |
|--|-------------|-------------|
| Discount rate as of December 31 | 4.50% | 4.50% |
| Average life term | 20 years | 20 years |
| Active service period | 0 years | 1 year |
| Pensioners entitled to Christmas bonus | 778 | 811 |
| Pensioners entitled to other bonuses | 5,070 | 5,186 |
| Pensioners not entitled to bonuses | 95 | 86 |
| Active serving workers entitled to Christmas bonus | 144 | 151 |

According to the Bank's management, the discount rate of 4.50% is being used because the Bank's financial instruments guarantees the existence of profitability rates higher than 4% with a long-term horizon.

The average life term and active service period have been determined based on the definition established in chart of accounts 20 of the Peruvian Board of Accountancy N° 159-2003-EF/93.01. A period of active service equal to zero implies that the active serving worker is in the condition to immediately become a pensioner.

The mortality tables used for actuarial calculations are the "Mortality Tables - 2005 Pension System (Peru)" for own right and right to healthy life, and the MI-85-H and the MI-85-M mortality tables depending if disabled person is a man or a woman, respectively, all of them approved by the MEF in Ministerial Resolution N° 757-2006-EF/15 and included as exhibit in Ministerial Resolution N° 146-2007-EF/15 dated March 23, 2007.

The pension reserves have been calculated applying a maximum pension amount equivalent to two (2) Tax Units (equivalent to S/. 7,200).

Maturities of Deposits and Obligations

As of December 31, the scheduled maturity dates for deposits and obligations are as follows:

| | <u>In thousands of S/.</u> | |
|-------------------|----------------------------|-------------------|
| | <u>2012</u> | <u>2011</u> |
| Up to 1 month | 5,363,563 | 4,570,740 |
| 1-6 months | 5,946,491 | 5,339,407 |
| 6 months - 1 year | 3,350,098 | 3,256,331 |
| More than 1 year | 6,678,732 | 6,863,664 |
| | ----- | ----- |
| | <u>21,338,884</u> | <u>20,030,142</u> |

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(13) Deposits in Financial System Companies and International Financial Entities

As of December 31, 2012, they include demand deposits for S/. 123,306 thousand and US\$ 100,893 thousand, and saving deposits for S/. 2,357 thousand (demand deposits for S/. 99,202 thousand and US\$ 100,313 thousand, and saving deposits for S/. 1,821 thousand as of December 31, 2011).

(14) Accounts Payable

They comprise the following:

| | <u>In thousands of S/.</u> | |
|--|----------------------------|----------------|
| | <u>2012</u> | <u>2011</u> |
| Remunerations and profit sharing payable | 61,397 | 59,769 |
| Suppliers (a) | 62,272 | 34,622 |
| Sundry accounts payable (b) | 39,729 | 54,071 |
| Others | 107 | 113 |
| | ----- | ----- |
| | <u>163,505</u> | <u>148,575</u> |

(a) Accounts payable to suppliers comprise mainly provisions for services such as custody, fund management and supply of funds to Multired's ATMs provided by Hermes and Prosegur amounting to S/. 13,711 thousand (S/. 11,078 thousand as of December 31, 2011), and provisions for various purchases made by the logistics department for S/. 38,022 thousand for the implementation of communication equipments, central of computation, anti-fraud applications maintenance, security, improvement of premises, among others.

(b) Sundry accounts payable mainly comprise obligations payable arising from a court decision against the Bank for S/. 13,486 thousand (S/. 34,211 thousand as of December 31, 2011) and transactions made through ATMs of other banks and premises affiliated to VISA pending confirmation for S/. 4,004 thousand and S/. 6,883 thousand, respectively (S/. 3,086 thousand and S/. 5,818 thousand as of December 31, 2011, respectively); likewise, transactions of external borrowing for Cajamarca Regional Government for infrastructure projects for S/. 6,767 thousand.

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(15) Provisions

They comprise the following:

| | <u>In thousands of S/.</u> | |
|--------------------------------------|----------------------------|-------------|
| | <u>2012</u> | <u>2011</u> |
| Provisions for contingent loans: | | |
| Generic | 4,934 | 7,040 |
| Specific | 727 | - |
| | ----- | ----- |
| | 5,661 | 7,040 |
| | ----- | ----- |
| Other provisions: | | |
| Provision for litigations and claims | 85,696 | 97,637 |
| Self-insurance reserve fund | 2,693 | 3,127 |
| Claims fund | 2,529 | 2,739 |
| Loan contingencies | 592 | 3,375 |
| Provision for country risk | 553 | 73 |
| Others | 5,100 | 5,392 |
| | ----- | ----- |
| | 97,163 | 112,343 |
| | ----- | ----- |
| | 102,824 | 119,383 |
| | ===== | ===== |

The provision for litigations and claims includes provisions for labor and pension claims as well as civil and arbitration proceedings filed against the Bank, in the amount of S/. 73,715 thousand and S/. 11,981 thousand, respectively (S/. 63,781 thousand and S/. 33,856 thousand, respectively as of December 31, 2011).

(16) Other Liabilities

They comprise the following:

| | <u>In thousands of S/.</u> | |
|--|----------------------------|-------------|
| | <u>2012</u> | <u>2011</u> |
| Transactions in progress | 123,679 | 130,744 |
| Agencies and branches in provinces | 1,661 | 2,247 |
| Cash excess | 1,124 | 1,946 |
| Deferred income from interest on repossessed goods and commissions from contingent operations | 1,728 | 1,845 |
| | ----- | ----- |
| | 128,192 | 136,782 |
| | ===== | ===== |

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Transactions in progress are those carried out during the last days of the month and are reclassified in the following month to their definitive respective accounts in the balance sheet. As of December 31, 2012, it mainly comprises cheques received from other banks which have not yet been cleared amounting to S/. 72,517 thousand (as of December 31, 2011, it mainly included pending transfers to the State implementing units through the BCRP for S/. 109,681 thousand).

(17) Equity

(a) Share Capital

The Bank's authorized capital amounts to S/. 1,000,000 thousand, fully subscribed and paid in by the Peruvian Government, pursuant to article 5 of the Bank's bylaws. No shares or securities are issued for the Bank's share capital.

(b) Legal Reserve

Under the Banking Act, banks shall reach a legal reserve of not less than 35% of its share capital. The reserve is made up through the annual transfer of at least 10% of net profits. Legal reserve as of December 31, 2012 and 2011, amounts to S/. 350,000 thousand, minimum amount required by the Banking Act.

(c) Retained Earnings

In conformity with article 40 of the Bank's bylaws, 50% of the net profit is used to cover the Bank's authorized capital, and the other 50% is for the Public Treasury. Once the authorized capital is covered, all of the net profit will go to the Treasury. As of December 31, 2012 and 2011, the Bank's authorized capital is 100% covered.

At Board of Directors Meeting N° 1895, held on March 21, 2012, the Board approved the distribution of the Bank's 2011 net profits to the Public Treasury. The amount distributed corresponded to 2011 net profits amounting to S/. 486,715 thousand less equity adjustments for S/. 7,430 thousand, consequently the amount of S/. 479,285 thousand was distributed in favor of Public Treasury as follows: S/. 143,786 thousand for the annual amortization of the Supreme Decree N° 002-2007-EF Bond (note 1 and 6 (d)) and remaining balances of S/. 335,499 thousand deposited in the checking account of the Public Treasury.

(d) Regulatory Net Worth

As of December 31, 2012, the Bank's regulatory net worth determined as per current legal rules amounts to approximately S/. 1,393,621 thousand (S/. 1,389,703 thousand as of December 31, 2011). This figure is used to calculate certain legal limits and restrictions according to the Banking Act, applicable to the Bank's operations in Peru and is determined as follows:

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| | <u>In thousands of S/.</u> | |
|-----------------------------|----------------------------|------------------|
| | <u>2012</u> | <u>2011</u> |
| Tier 1 | | |
| Paid-in capital | 1,000,000 | 1,000,000 |
| Legal reserve | 350,000 | 350,000 |
| Donations | 952 | 677 |
| Other deductions | (12,156) | (9,728) |
| | ----- | ----- |
| | 1,338,796 | 1,340,949 |
| | ----- | ----- |
| Tier 2 | | |
| Generic provision for loans | 66,981 | 58,482 |
| Other deductions | (12,156) | (9,728) |
| | ----- | ----- |
| | 54,825 | 48,754 |
| | ----- | ----- |
| Total regulatory net worth | <u>1,393,621</u> | <u>1,389,703</u> |

As of December 31, 2012, according to legislation applicable to financial institutions, the assets and contingent loans weighted by credit risk determined by the Bank amounted to S/. 5,306,307 thousand (S/. 4,624,262 thousand as of December 31, 2011).

According to the Banking Act, the regulatory capital shall be equal to or higher than 10% of total risk weighted asset and contingent credits corresponding to the sum of: (i) regulatory capital requirement for market risk multiplied by 10, (ii) regulatory capital for operational risk multiplied by 10, and iii) risk weighted asset and contingent credits multiplied by 10. Such calculation shall include all exposure or asset in local or foreign currencies. The 10% requirement mentioned above was implemented in July 2011, according to Legislative Decree N° 1028. As of December 31, 2012, the Bank's regulatory capital represents 19.24% of the minimum capital requirements for market, operational and credit risk (23.05%, as of December 31, 2011).

On April 2, 2009, the SBS enacted Resolution N° 2115-2009 approving the rules for the Regulatory Net Worth Requirement of Operational Risk, which was effective July 1, 2009. On this respect, we should mention that as of the date of this report, the Bank has applied the base-indicator method for the calculation of the regulatory net worth for operational risk.

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On July 20, 2011, the SBS enacted Resolution N° 8425-2011 approving the Regulations on Additional Regulatory Net Worth Requirement indicating that regulatory net worth shall be equal to the sum total of regulatory capital requirements, calculated per each of the following components: i) economic cycle, ii) concentration risk, iii) market risk concentration, iv) interest rate risk in banking records, and v) other risks. This additional requirement came into force progressively as from July 2012. As of December 31, 2012, the additional regulatory net worth amounts to S/. 74,577 thousand.

Minimum regulatory net worth requirement as of December 31, 2012:

| | <u>In thousands of S/.</u> |
|---|----------------------------|
| Regulatory net worth requirement of credit risk | 530,631 |
| Minimum regulatory net worth requirement of credit, market and operational risks | 724,312 |
| Additional regulatory net worth requirement | 74,577 |
| Total regulatory net worth requirement | 798,889 |
| Calculated regulatory net worth | 1,393,621 |
| Global regulatory net worth excess | 594,732 |

(18) Contingencies

As of December 31, 2012, the Bank has various pending proceedings for claims and appeals resulting from its normal operating activities and in management's opinion, no significant liabilities, additional to those already recorded by the Bank, will arise (note 15).

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(19) Contingent and Memoranda Accounts

They comprise the following:

| | <u>In thousands of S/.</u> | |
|--|----------------------------|-------------|
| | <u>2012</u> | <u>2011</u> |
| Contingent operations: | | |
| Indirect loans (a): | | |
| Granted stand-by letters | 341,921 | 134,002 |
| Letters of credit | 188,855 | 537,341 |
| | ----- | ----- |
| | 530,776 | 671,343 |
| Unused credit lines and undisbursed approved loans | 1,258,645 | 1,351,735 |
| Litigations, pending claims, and other contingencies | 1,080 | 355 |
| | ----- | ----- |
| | 1,790,501 | 2,023,433 |
| | ----- | ----- |
| Memoranda accounts: | | |
| Write-off of bad debts (b) | 51,851,669 | 3,895,640 |
| Bank's securities in collection | 3,393,379 | 3,120,683 |
| Collateral received for credit operations | 1,617,931 | 1,226,284 |
| Interest on loans and income-in-suspense (b) | 1,592,952 | 53,595,797 |
| Payment approval - Public Treasury | 1,512,814 | 1,179,530 |
| Guarantees Supreme Government foreign debt (c) | 1,051,783 | 1,097,507 |
| Portfolio, guarantees and credit transfer | | |
| MEF/Banco Latino | 850,539 | 850,128 |
| D.U. N° 065-2002 frozen savings | 89,210 | 55,475 |
| Guarantees received for services | 68,251 | 63,603 |
| Supreme Government liabilities for foreign debt | - | - |
| Bank's goods and securities in custody | 12,091 | 12,551 |
| Loans on behalf of third party | 3,564 | 51,820 |
| Consignments received | 735 | 743 |
| Payment schedule - Ministry of the Presidency | - | 352 |
| Other debit memoranda accounts | 693,834 | 820,603 |
| Other credit memoranda accounts | 2,194,769 | 1,882,459 |
| | ----- | ----- |
| | 64,933,521 | 67,853,175 |
| | ----- | ----- |
| Trustee (d) | 1,248,952 | 1,458,748 |
| | ----- | ----- |
| | 67,972,974 | 71,335,356 |
| | ===== | ===== |

- (a) In the normal course of its operations, the Bank performs contingent operations that expose it to additional credit risk beyond the amount recognized in the balance sheet. The credit risk in contingent operation is defined as the possibility of a loss occurring as a result of the failure of one of the parties in contingent operations to comply with the terms of the agreement.

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The credit risk of the Bank of granted stand-by letters is the amounts agreed upon in these instrument agreements. As the majority of contingent operations will expire without any withdrawing from the Bank, they do not necessarily represent future cash outflows.

Letters of credit and granted stand-by letters are contingent commitments taken by the Bank to guarantee that a customer performs its obligations to a third party. Letters of credit are mainly issued as credit-related guarantees used to facilitate commercial transactions abroad. The risk associated with these credits is minimized because there are guarantee deposits made by Bank's clients.

- (b) Interest on loans and income-in-suspense comprise interest and commissions generated principally from overdue and loans in legal collection. The decrease of this item is due mainly to the write-off of the Ex-Surneban loan portfolio which could not be sold in the bid of bad debts launched by FONAFE, approved in Board Agreement N° 1761 of June 4, 2009, for S/. 51,343 thousand. This bad debt loan portfolio was written off and recorded in memoranda accounts as written-off bad debts.
- (c) The Supreme Government guarantees and liabilities account for foreign debt are operations in which the Bank participates as financial agent on behalf of the Government to implement loans agreed among Peru and other countries, mainly through bilateral refinancing agreements and the Paris Club, as well as financial entities and suppliers in lien of corresponding legal provisions.

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(d) The Bank manages, as trustee, the following equity trusts:

| | In thousands of S/. | |
|--|---------------------|------------------|
| | 2012 | 2011 |
| Equity trust fund 036-2000 and RM 099-2000-EF/10 | 525,675 | 597,552 |
| MINDES – FONCODES-BN Trust | 171,201 | 172,497 |
| Arequipa Regional Government – Majes II | 120,673 | 54,819 |
| Olmos Tinajones | 108,496 | - |
| SEDAPAR Pampa Escalerilla | 58,368 | - |
| D.U. Fiduciary Trust 034-99 | 47,996 | 67,726 |
| EMPSSAPAL Trust | 45,719 | 44,564 |
| Loreto Regional Government – PAFE III | 43,503 | 47,931 |
| Cajamarca Regional Government - Drinking Water and Sewerage | 40,068 | 143,763 |
| Loreto Regional Government– Banco de la Nación | 17,810 | 126,170 |
| MML-BIRF-BID Urban Transport | 15,002 | 12,337 |
| SEDACUSCO – BN | 11,912 | 8,415 |
| Cajamarca Regional Government – PAFE III | 9,657 | 43,853 |
| Navy trust RM-307-2006-EF/75 | 7,796 | 37,997 |
| Peruvian Navy -MEF | 4,673 | - |
| Colcabamba municipality | 4,183 | - |
| PMRI I EPS Chavín S.A. | 3,095 | - |
| Gore Callao - Nuevo Gambeta project | 2,781 | - |
| PMRI I EPS Moquegua S.A. | 2,286 | - |
| PMRI I MAPA Huaral S.A. | 1,903 | - |
| PMRI I SEDA Huánuco S.A. | 1,869 | - |
| Cuzco Regional Government - COPESCO Plan trust | 1,049 | - |
| Ministry of Energy and Mines - UGP FONER CF | 272 | 12,267 |
| Armed Forces Fund | 245 | 25,453 |
| Cuzco Regional Government - Meriss Plan trust | 98 | 428 |
| EPS SED ALORETO-BN trust | 88 | 1,278 |
| EPSEL S.A. Trust | - | 224 |
| EPS SEDAPAR-BN Trust | - | 61,474 |
| Others | 2,534 | - |
| | <u>1,248,952</u> | <u>1,458,748</u> |

The assets held in trust are not included in the Bank's financial statements. However, the Bank is responsible for the appropriate management of such trusts up to the limits established by corresponding law and contracts.

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(20) Finance Income

They comprise the following:

| | <u>In thousands of S/.</u> | |
|---|----------------------------|------------------|
| | <u>2012</u> | <u>2011</u> |
| Interest and commissions on direct credits | 552,233 | 489,819 |
| Interest on cash and due from banks | 316,535 | 306,502 |
| Income from trading and held-to-maturity investments | 199,594 | 181,290 |
| Foreign exchange difference from operations | 72,289 | 91,731 |
| Income from valuation of trading and held-to-maturity investments | 24,981 | - |
| Trading of securities | 5,246 | 20,527 |
| Other interest income | 3,504 | 1,144 |
| Interest and commissions on banks funds | - | 234 |
| | ----- | ----- |
| | <u>1,174,382</u> | <u>1,091,247</u> |

Increase in interest on cash and due from banks corresponds to the higher balance in cash and due from banks funds that the Bank holds at BCRP during year 2012. Interest rate on the Bank's funds held at a special account at BCRP reduced from 3.5% in December 2011 to 2.5% in December 2012. As a result of this fall in the rate, the Bank transferred the funds held at the special account at BCRP as term deposits that bear interest rate ranging from 2.08% to 3.50%.

(21) Finance Expense

They comprise the following:

| | <u>In thousands of S/.</u> | |
|---|----------------------------|---------------|
| | <u>2012</u> | <u>2011</u> |
| Interest and commissions on deposits and obligations | 51,534 | 51,419 |
| Trading of securities | 17,802 | 6,770 |
| Other interest expenses | 53 | 714 |
| Loss on valuation of trading and held-to-maturity investments | - | 20,130 |
| | ----- | ----- |
| | <u>69,389</u> | <u>79,033</u> |

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(22) Income from Finance Services

They comprise the following:

| | <u>In thousands of S/.</u> | |
|---|----------------------------|----------------|
| | <u>2012</u> | <u>2011</u> |
| Income from cash desk services (a) | 334,352 | 296,752 |
| Revenues from transfers services | 75,966 | 81,521 |
| Revenue from tax collection services | 40,897 | 37,637 |
| Commissions on insurance sales | 19,914 | 21,854 |
| Commissions on credit and debit cards use | 24,492 | 21,591 |
| Services for shared premises | 8,718 | 13,120 |
| Revenue from collections | 7,670 | 7,020 |
| Revenues from contingent operations | 3,480 | 4,407 |
| Others (b) | 84,233 | 78,643 |
| | ----- | ----- |
| | <u>599,722</u> | <u>555,525</u> |

(a) Income from cash desk services correspond mainly to commissions for management of funds collected by the Bank for the General Direction of Treasury for S/. 274,374 thousand, Multired ATMs for S/. 35,490 thousand and correspondent services for S/. 20,292 thousand (S/. 240,639 thousand, S/. 33,858 thousand and S/. 18,930 thousand, respectively for year 2011).

(b) The other revenues from finance services correspond mainly to commission on cheques received from other banks for S/. 9,933 thousand, commissions for issuance of new debit Multired debit cards for S/. 7,272 thousand, commission for services to ONP for S/. 5,937 thousand, commission for services to social programs for S/. 5,509 thousand, commissions for interbanking transfers for S/. 4,010 thousand, other commissions on checking accounts and savings accounts for S/. 34,297 thousand, among others (for S/. 56,265 thousand in 2011).

(23) Administrative Expenses

They comprise the following:

| | <u>In thousands of S/.</u> | |
|-----------------------------------|----------------------------|----------------|
| | <u>2012</u> | <u>2011</u> |
| Personnel and Board expenses (a) | 536,078 | 650,142 |
| Third party services expenses (b) | 210,205 | 192,398 |
| Taxes (c) | (16,440) | 37,115 |
| | ----- | ----- |
| | <u>729,843</u> | <u>879,655</u> |

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- (a) In 2012, personnel and board expenses principally include personnel salaries amounting to S/. 340,738 thousand, and the retirement pension provision amounting to S/. 104,801 thousand (S/. 319,908 thousand and S/. 186,278 thousand, respectively in 2011).
- (b) In 2012, third party service expenses principally comprise the insurance amounting to S/. 21,623 thousand, police forces amounting to S/. 20,382 thousand, communications amounting to S/. 20,524 thousand, service providers for S/. 20,186 thousand, repairing and maintenance for S/. 20,101 thousand, surveillance for S/. 15,291 thousand, leases for S/. 14,409 thousands, and the workers' fund for the health care program - PAM amounting to S/. 14,134 thousand.
- (c) As of December 31, 2012, the tax item shows a credit balance net of S/. 16,440 thousand, because in March 2012, Tax Authorities (SUNAT) refunded the year 2006 income tax paid in excess for S/. 57,701 (principal of S/. 41,907 thousand and interest of S/. 15,795 thousand), as per Superintendency Resolution N° 012-180-0004372/ SUNAT of March 6, 2012.
- (24) Assets Valuation and Provisions
They comprise the following:

| | <u>In thousands of S/.</u> | |
|---|----------------------------|----------------|
| | <u>2012</u> | <u>2011</u> |
| Depreciation of properties, furniture and equipment | 38,813 | 36,438 |
| Provision for litigations and claims | 17,843 | 43,153 |
| Provision for doubtful loans | 14,221 | 10,658 |
| Amortization of intangible assets | 8,933 | 9,302 |
| Provision for contingent loans | 3,279 | 781 |
| Others | 1,718 | 252 |
| | <u>84,807</u> | <u>100,584</u> |

Provisions for litigations and claims comprise provisions for labor proceedings amounting to S/. 17,002 thousand for civil trials amounting to S/. 841 thousand (provisions for labor proceedings amounting to S/. 28,941 thousand and for civil trials amounting to S/. 14,212 thousand in 2011).

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(25) Other Income and Expenses, Net

They comprise the following:

| | <u>In thousands of S/.</u> | |
|-----------------------------------|----------------------------|-------------|
| | <u>2012</u> | <u>2011</u> |
| Other income: | | |
| Various income | 57,524 | 42,491 |
| Other extraordinary income | 3,385 | 6,051 |
| Net income from credit recovery | 87 | - |
| | ----- | ----- |
| | 60,997 | 48,542 |
| | ----- | ----- |
| Other expenses: | | |
| Extraordinary expenses | (4,768) | (23,132) |
| Various expenses | (20,453) | (285) |
| Net expenses from credit recovery | - | (1) |
| | ----- | ----- |
| | (25,221) | (23,418) |
| | ----- | ----- |
| Other income and expenses, net | 35,776 | 25,124 |
| | ===== | ===== |

In 2012, the various income item mainly comprise the recovery of provisions for litigations and claims amounting to S/. 23,540; revenues from the readjustment of improvements in leased property for S/. 14,473 thousand with a balancing entry in the other various expenses item for S/. 20,246 thousand; recovery of generic provisions for contingent loans for S/. 4,405 thousand; reversal of various provisions for S/. 6,440 thousand; revenues from the accounting restructuring of liabilities for S/. 2,852 thousand, partial recovery of the fund for contingencies corresponding to 1% of Multired loans granted during years 2001 through 2007 without insurance coverage in case of death amounting to S/. 2,778 (in 2011, it mainly comprises the recovery of provisions for accounts receivable for S/. 12,379 thousand, according to Law 29608, Law for Accounting Restructuring (note 2(e)) and the recovery of the provisions for contingent loans for S/. 6,236 thousand).

(26) Workers' Profit Sharing

The Bank's workers are entitled to a profit sharing plan to be computed on 5% of annual taxable income.

In 2012, the Bank determined that the legal workers' profit sharing amounted to S/. 28,200 thousand (S/. 14,687 thousand in 2011) and is recorded as personnel charges (note 23).

(27) Tax Matters

(a) Fiscal years 2006 through 2012, inclusive, are open to review by Peruvian tax authorities; except for period 2010 which is currently under review. In 2012 and 2011, the Bank submitted to tax authorities an application for the refund of the income tax determined for fiscal periods 2006 and 2005, respectively. Any major expenses exceeding the provisions made to cover the tax obligations will be charged

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to the results of the year in which those expenses are finally settled. The Bank's management and tax advisors consider that no significant liabilities affecting the financial statements as of December 31, 2012 will arise as a result of such review.

In accordance with current tax legislation, corporate income tax for 2012 and 2011 is calculated on the basis of the net taxable profit at a rate of 30%.

Bank's income tax for the period ended December 31, 2012 amounts to S/. 160,740 thousand (S/. 83,714 thousand as of December 31, 2011).

Calculation:

| | In thousands of S/. | |
|---|---------------------|------------|
| | 2012 | 2011 |
| Profit before income tax | 835,104 | 559,630 |
| Plus: | | |
| Non-accepted expenses | 317,206 | 311,707 |
| Less: | | |
| Exempted income and taxed income from previous years | (616,512) | (592,290) |
| Taxable income | 535,798 | 279,047 |
| Current income tax | 160,740 | 83,714 |

- (b) In 2005, a new tax named Temporary Tax on Net Assets (ITAN, for its Spanish acronym) was established. The taxable base is the prior period adjusted net asset value less depreciations, amortizations, legal cash reserve, and specific provisions for credit risk. Tax rate is 0.4% for 2012 and 2011 and is applied over net assets exceeding S/. 1,000 thousand. It may be paid in cash or in nine consecutive monthly installments. The paid amount can be used as a credit for partial payments of income tax general regime for the taxable periods from March to December of the fiscal period in which the tax was paid until maturity date of each of the partial payment, and against the payment for regularization of income tax of the corresponding taxable period. The Bank has determined that temporary tax on net assets amounts to S/. 91,454 thousand (S/. 85,613 thousand in 2011).

Tax refund can be requested only in the cases where it can be demonstrated that tax loss has been incurred or where a lower payment of income tax has been determined based on general regime norms.

- (c) Since 2010, capital gains are subject to income tax. In this regard, it has been established, among others, that the tax cost of securities whose disposition was tax-exempt until December 31, 2009 since they were traded at stock exchange, will be the higher between: (i) market value as of December 31, 2009, (ii) acquisition cost, or (iii) increase in the equity value, following the procedures described in Executive Order 011-2010-EF. This rule is applicable to legal entities when securities are negotiated through or outside centralized trading mechanisms in Peru.

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Beginning January 1, 2010, only interest and capital gains from bonds issued by the Republic of Peru are income tax-exempt if: (i) under Executive Order 007-2002-EF, (ii) under the Market-Makers program or the replacing mechanism, or (iii) in the international market since 2002; as well as interest and capital gains from obligations from the Peruvian Central Reserve Bank (except for those from legal cash reserve requirements deposited by credit institutions); and those coming from the direct or indirect disposition of securities that are traded or underlying Exchange Traded Fund (ETF) that replicate indexes constructed having as reference national investment instruments, when such disposition is made for the creation, payment or management of an investment portfolio of ETFs. Interest and capital gains from corporate bonds issued before March 11, 2007 are also tax-exempt, under certain conditions.

- (d) Technical assistance provided by non-domiciled legal entities will be subject to a 15% withholding income tax, regardless of the location the service was rendered, and that Income Tax Law requirements are met.
- (e) As of December 31, 2012 and 2011, the tax rate on financial transactions was 0.005%. Tax is applied on charges and debits in bank accounts or movements of funds made through the financial system, unless accounts are tax-exempt.
- (f) Reconciliation of income tax effective rate to the tax nominal rate is as follows:

| | 2012 | | 2011 | |
|--|------------------------|--------------|------------------------|--------------|
| | In thousands of S/. | % | In thousands of S/. | % |
| Profit before income tax | 835,104 | 100.00 | 559,630 | 100.00 |
| Income tax calculated at nominal rate | 250,531 | 30.00 | 167,889 | 30.00 |
| Tax effect on additions and deductions for permanent differences | (84,231) | (10.09) | (94,974) | (16.97) |
| Current and deferred income tax at effective rate | <u>166,300</u> | <u>19.91</u> | <u>72,915</u> | <u>13.03</u> |

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(g) Income tax expense comprises:

| | <u>In thousands of S/.</u> | |
|--------------------|----------------------------|---------------|
| | <u>2011</u> | <u>2010</u> |
| Current | 160,740 | 83,714 |
| Deferred (note 10) | 5,560 | (10,799) |
| | <u>166,300</u> | <u>72,915</u> |

(28) Fair Value of Financial Instruments

Fair value is the amount for which an asset could be exchanged between knowledgeable willing parties, or a liability settled between a debtor and a creditor in an arm's length transaction. Fair value is not the amount that the Bank may receive or pay in a forced transaction, in an involuntary settlement, or in a sale in the case of financial difficulties.

The following information provides a disclosure of the fair value of the financial instruments owned by the Bank, and required by accounting principles. Various limitations are inherent in the fair value presentation, including the following:

- The data excludes non-financial assets and liabilities, such as property, furniture and equipment, and other assets and liabilities.
- Due to the fact that the data represents management's best estimates, significant estimates regarding current economic and characteristics of market risk are required.

The methods and estimates used by the Bank to estimate the fair value of financial instruments include the following:

- Cash and due from banks represent cash and short-term deposits that are not considered to be a significant credit risk. Therefore, their carrying amount is close to fair value.
- Fair value of available-for-sale investment is close to carrying amount since they are valued at market value. Held-to-maturity investments that do not have a market value due to their non-negotiable condition are recorded at amortized cost.
- The carrying amount of loans is affected by the recording of generic and specific provisions. The Bank has not determined the market value of such credits and considers that the net carrying amount of loans is lower than their corresponding market value, and assumes a conservative position.
- Financial obligations accrue interest at variable and preferred rates taking into consideration that carrying amounts are similar to their corresponding market values.

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- The Bank conducts various contingent operations, as granting guarantees, standby letters, letters of credit and other. These operations expose the Bank to credit risks additional to the figures recognized in the financial statements. Based on the level of commissions collected for the conduction of these operations and considering the maturity and interest rates as well as the solvency of the counter parties of these operations, the value is not material. Due to the uncertainty to determine the likelihood and the timing in which those guarantees can become demandable, and due to the fact that there is not real market to trade them, it is not feasible for the Bank to determine the fair value of the guarantees granted.

(29) Financial Risk Management

The Bank is exposed to a variety of financial risks that include effects of foreign exchange fluctuations, interest rates, credit concentration, and liquidity requirements. Based on the Bank's policies, its knowledge of the market and experience in the sector, management has established policies for the control of risks that cover credit, liquidity, interest rate and currency risks, in order to minimize potential adverse effects in its financial behavior.

(a) Credit Risk

As part of its financial intermediation activities the Bank grants loans to its customers, in particular Public Sector Workers and Pensioners, as well as Local and Regional Governments, financial intermediation institutions (agricultural and municipal credit unions and SME development entities), and public sector agencies. The largest concentration of loans goes to Public Sector Workers and Pensioners, representing approximately 45% of direct loans and indirect loans, which amounts to approximately S/. 2,825,951 thousand.

Credit risk is controlled at the Bank mainly through the assessment and analysis of individual transactions. In 2012, the main component of the loan portfolio was consumer loans to Public Sector Workers and Pensioners, which represents a lower risk because the remunerations of these borrowers are deposited in the Bank. An analysis of the portfolio is provided in note 7. Information on the deposits and other liabilities appears in note 12.

The Bank also manages credit risk by periodically conducting a formal review and analysis of individual transactions in the loan portfolio, for which purpose it assesses the borrower, financial conditions and security requirements.

(b) Liquidity Risk

Liquidity risk implies keeping or developing a balance structure both in the assets portfolio and in the liabilities portfolio, in order to keep a variety of financing sources and staggered maturity dates between assets and liabilities. The Bank controls its liquidity by balancing asset and liability maturities.

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(c) Interest Rate Risk

The Bank is exposed to movements of interest rates when a change in the market interest rate results in a change in the Bank's interest expense, but no similar change occurs in the interest income as compensation. The Bank manages the interest rate risk through monthly measurements of interest rate risk exposure to determine gains on risk and equity exposure on risk according to the SBS requirements and risk valuation methodologies.

Essentially, all the Bank's financial assets accrue interest. Its financial liabilities include both non interest-bearing and interest-bearing liabilities. Interest-bearing assets and liabilities are based on rates set in accordance with the regulations in force.

(d) Exchange Risk

Exchange risk is the risk of financial loss to the Bank due to adverse fluctuation in the value of financial assets and liabilities arising from variations in exchange rates. The risk magnitude depends on the imbalance of the Bank's assets and liabilities in foreign currency and on the exchange rate of the underlying contract of the foreign currency transactions pending as of the closing.

The Bank carries out transactions in foreign currency mainly in U.S. dollars related to financing activities mostly; therefore it is exposed to exchange rate fluctuation risk. Net assets exposed to exchange rate fluctuation risk are disclosed in note 4.