

EXECUTIVE SUMMARY

INTRODUCTION

The AFP Retirement and Separation Benefits System (AFPRSBS) was created by virtue of Presidential Decree (PD) No. 361, which was promulgated on December 30, 1973 and started operations in 1976. The System was established as a funding mechanism to ensure the continuous payment of retirement and separation benefits to the members of the Armed Forces of the Philippines (AFP). Certain provisions of PD 361 pertaining to membership and rate of contributions were amended by PD 1656 dated December 21, 1979 and PD 1909 dated March 22, 1984 to strengthen the AFPRSBS.

The registered business and office address of the System is at No. 424 Capinpin Avenue, Camp General Emilio Aguinaldo, Quezon City, Metro Manila Philippines. It has no other offices within and outside the Philippines.

The System is engaged in various business operations which include the management of funds invested in the stock market, money market, government and corporate bonds, corporate loans, real estate properties and equity holdings in subsidiaries and associates. It also has interests and participation in real estate projects involving the development and construction of commercial and subdivision projects, memorial parks, golf courses, and, for some, in partnership with reputable real estate developers. In the course of the System's lending operations, it also acquires through foreclosure proceedings and *dacion en pago* arrangements, mortgaged real estate properties as payment for the full or partial settlement of the loan obligations of the System's borrowers. The inventory of developed lots, condominium units and acquired assets are being offered for sale to the military personnel and to the public as well to recoup the System's principal investments.

The AFPRSBS Board of Trustees, consisting of 11 members, is the policy making body of the System. The President/Chief Executive Officer as well as the Executive Vice President/Chief Operating Officer take charge of the day to day affairs of the organization. As at December 31, 2014, the System has 83 regular and 42 contractual personnel or a total workforce of 125 personnel.

The AFPRSBS Revenue, Expense, Capital Outlay and Cash Flow Budget (Corporate Operating Budget) for CY 2014 approved per Board Resolution No.01-2014 dated January 28, 2014 amounted to P241,805,266 broken down as follows:

Particulars	Approved Budget	Utilization	Variance
Personnel services	95,355,941	81,216,107	14,139,834
Maintenance and operating expenses	140,912,259	68,725,818	72,186,441
Capital expenditures	5,537,066	1,109,693	4,427,373
Total	241,805,266	151,051,618	90,753,648

FINANCIAL HIGHLIGHTS (in Philippine Peso)

I. Comparative Financial Position

Particulars	2014	2013	Increase (Decrease)
Assets	15,810,032,300	15,013,208,478	796,823,822
Liabilities	4,855,383,251	4,536,098,621	319,284,630
Fund equity	10,954,649,049	10,477,109,857	477,539,192

II. Comparative Results of Operations

Particulars	2014	2013	Increase (Decrease)
Gross income	335,449,020	263,842,255	71,606,765
Investment and operating expenses	67,197,013	32,255,230	34,941,783
General and administrative expenses	107,137,254	88,754,778	18,382,476
	174,334,267	121,010,008	53,324,249
Net income	161,114,753	142,832,247	18,282,506

SCOPE OF AUDIT

Our audit covered the examination on a test basis, the accounts and operations of the AFPRSBS for the calendar year ended 2014. It was aimed at ascertaining the propriety of the financial transactions, compliance of the System with prescribed laws, rules and regulations, and ascertaining the fairness of the presentation of the financial statements in accordance with the International Standards in Auditing.

INDEPENDENT AUDITOR'S REPORT

The Auditor rendered an adverse opinion on the fairness of presentation of the financial statements for CY 2014 of the AFPRSBS in view of the overstatement of assets by P2.542 billion due to: a) non-consolidation of the financial statements of the System and its subsidiaries and failure to eliminate the reciprocal accounts which overstated the Investment in Shares of Stocks by P2.547 billion and Advances to Subsidiaries and Associates by P10.828 million contrary to pertinent provisions of Philippine Financial Reporting Standards (PFRS) 10; b) non-recognition and non-accrual of rental income based on the amount received or to be received from the lessees which understated the Accounts Receivable, Trade-Lessees by P7.670 million while the delay in the recognition of real estate transactions and other errors in recording sales understated Installment Contract Receivable by P9.224 million and overstated Investment in Real Estate by P3.968 million; c) error in the amortization of a prepaid account which overstated the Prepaid Repairs and Maintenance by P0.037 million; d) understatement of Stock Investment by P0.732 million due to non-deduction of the carrying value from the value of the stocks sold; e) the understatement of Cash in Bank by P1.513 million due to unclaimed/stale check not reversed in the books of accounts, and f) the consequent understatement in the liabilities and overstatement in the equity accounts

by P3.486 million and P2.546 billion respectively, due to the said errors summarized in the following table:

Obs. No.	Nature of errors/ deficiencies	Accounts affected	Under-(Over-) statement In millions)
1	Non-consolidation financial statements of the System's subsidiaries and controlled entities	Investments in stocks	(2,546.784)
	Failure to eliminate reciprocal accounts	Advances to Subsidiaries	(10.828)
4	Non-recognition and the non accrual of rental income based on the amount received or to be received from the lessees	Accounts Receivable, Trade - Lessees	7.670
6	Error in the amortization of prepaid repairs and maintenance	Prepaid Repairs & Maintenance	(0.037)
8	Net effect of unrecognized Cost of Real Estate Sales, sales revenue and sales discounts	Installment Contract Receivable	9.224
		Investment in Real Estate	(3.968)
10	Non-deduction of the carrying value from the value of stocks sold	Stock Investment	0.732
Prior Year's Recommendation not implemented in CY 2014			
8	Unclaimed/stale checks not reversed in the books	Cash in Bank	1.513
Net errors in total asset			(2,542.478)
Total assets			15,810.032
% of Errors to total asset			(16.081%)
Materiality level			75.066
3	Unremitted VAT withheld recorded as Rental Income	VAT withheld	0.886
8	Net effect of unrecognized payable for CY 2014 and prior years and error in recording sales discount	Accounts Payable-Real Estate Brokers	1.330
		Due to Parent	(0.243)
11	Software recorded as Office machineries and equipment	Intangible Assets	3.197 (3.197)
Prior Year's Recommendation not implemented in CY 2014			
8	Unclaimed/Stale checks not reversed in the books	Various Accounts Payable	1.513

Obs. No.	Nature of errors/ deficiencies	Accounts affected	Under- (Over-) statement In millions)
Net errors in total liabilities			3.486
Total liabilities			4,855.383
% of Errors to total liabilities			0.072%
Materiality level			75.066
1	Non-consolidation of financial statements of the System's subsidiaries and controlled entities	Equity	(2,546.784)
	Failure to eliminate reciprocal accounts		(10.828)
3	Unremitted VAT withheld recorded as Rental Income	Equity	(0.886)
4	Non-recognition and the non-accrual of rental income based on the amount received or to be received from the lessees	Equity	7.670
6	Error in the amortization of prepaid repairs and maintenance	Equity	(0.037)
8	Delays in the recognition of Real Estate transactions due to the following		
	<ul style="list-style-type: none"> Net effect of unrecognized sales for CY 2014 and prior years 10.856 Net effect of unrecognized cost of sales, commission and discounts for CY 2014 and prior years (6.687) 	Equity	4.169
10	Non-deduction of the carrying value from the value of stocks sold	Equity	0.732
	Net effect of gain/loss recognized through Profit and loss instead of Cumulative Unrealized Gain from FVOCI	Equity	10.937
	Cumulative Unrealized Gain from FVOCI	Equity	(4.137)
	Cumulative Unrealized Loss from FVOCI	Equity	(6.800)
	Unrealized gain on changes in fair value of Available for Sale stock investment recognized at Income though profit and loss instead of FVOCI	Equity Equity	11.278 (11.278)
Net errors in total equity			2,545.964
Total Equity			10,954.649
% of Errors to total equity			(23.241%)
Materiality level			75.066

For the above mentioned audit observations, which caused the issuance of an adverse opinion, we recommended the following courses of action:

On the non-consolidation of financial statements of the System's subsidiaries and controlled entities and failure to eliminate reciprocal accounts:

1.1 Prepare the consolidated financial statements to include the assets, liabilities and results of operation of its subsidiaries; and

1.2 Eliminate all parent and subsidiary reciprocal account balances during the process of consolidation.

2. On the non-recognition and the non-accrual of rental income based on the amount received or to be received from the lessees:

2.1 Produce/retrieve the details of the rental income for 2012 and 2013 and then establish the effect of the non-compliance with PAS 17 in said years on the year-end AR, Trade – Lessees.

3. On the error in the amortization of prepaid repairs and maintenance:

3.1 Investigate and reconcile the noted unsubstantiated balances in each item of the prepaid expenses and adjust the accounts.

4. On the delay in the recognition of Real Estate transactions due to unrecognized sales for CY 2014 and prior years and unrecognized cost of sales, commission and discounts for CY 2014 and prior years:

4.1 Establish and maintain necessary control activities to ensure proper recording of real estate sale transactions, including but not limited to:

- Recognizing real estate sales when payments are received by Marketing Manager and other agents/brokers regardless of remittance of the same to the System; and
- Enforcing compliance by Marketing Manager and other agents/brokers to timely report sales for proper recording and remit payments from buyers within the period specified in the Marketing Agreement including contractually agreed penalties on late remittances.

5. On the non-deduction of the carrying value on the value of stocks sold and the effect of gain/loss recognized through Profit and loss instead of Cumulative Unrealized Gain from FVOCI:

5.1 Prepare the adjusting entries to correct the Stock investment account and Retained Earnings by P731,580;

5.2 Treat its stock investment as Available-For-Sale financial asset and adopt the accounting policy for it; and adjust the following subsidiary ledger balances-Recovery from DMV of stocks totaling P15.322 million and Provision for decline in market value of

short-term investment) totaling P4.236 million as part of the profit/loss and instead recognize an unrealized gain/(loss) of P11.278 million in other comprehensive income portion of Comprehensive Income for the remaining stock investment.

6. On the unclaimed/stale checks not reversed in the books:

6.1 Report the stale checks in the List of Unclaimed Checks as cancelled and for the Controllershship Department (CD) to prepare the necessary adjusting entries to take up the cancellation of the stale checks in the books of accounts.

7. On the Software recorded as Office machineries and equipment:

7.1 Include the accounts intangible asset and amortization in the chart of accounts of the system; and

7.2 Record the amount of P3.197 million as intangible assets to comply with Paragraph 8 of PAS 38.

On the other hand, the following observations may further impact on the account balances presented in the financial statements, however, due to some limiting circumstances, we were not able to determine the effect on the presentation, recognition, valuation and measurement of the said account balances:

1. The absence of subsidiary ledgers (SL) schedules from which to substantiate eight accounts receivable (AR) amounting to P171.713 million; AR-Non-Trade/Other Accounts totaling to P6.509 million; the discrepancies of P49.455 million between the trial balance (TB) and its Subsidiary Ledger (SL) schedule; and the negative/abnormal balance of P15.491 million in some schedules cast doubt on the reliability and accuracy of the respective account balances as reflected in the financial statements, contrary to pertinent provisions of Presidential Decree (PD) No. 1445 and the Philippine Conceptual Framework for Financial Reporting. Moreover, a defect in the Integrated Financial Management System (IFMS) Lending Module resulted in erroneous transaction.

1.1 We recommended that Management require the CD and the concerned operating departments to:

a. Prioritize the preparation of SL schedules for every account and reconcile the balances to come up with correct and reliable account balances to comply with Section 114 of PD 1445;

b. Investigate the causes of the discrepancies between TB and SL schedules and the existence of negative/abnormal items in the schedules including a review and analysis of the validity of the items; and

c. For the car loan, review and reconcile the transaction in the IFMS-Lending module to the individual's payroll deductions and make the necessary adjustments;

- d. Enhance the IFMS-Lending module to produce correct results; and
 - e. Make the necessary adjustments for fair presentation of the accounts in the financial statements.
2. Lack of supporting schedules and various discrepancies totaling to P24.646 million on prepaid expenses account casts doubt on the reliability of the account balances as of December 31, 2014. Moreover, items not currently realizable within the succeeding year were included as part of Prepayments under current assets contrary to Paragraph 57 of PAS 1 – Presentation of Financial Statements.
- 2.1 We recommended that Management:
- a. Submit all documents to prove the reliability of the transactions;
 - b. Investigate and reconcile the noted unsubstantiated balances in each item of the prepaid expenses and adjust the accounts, as necessary;
 - c. Require the concerned operating departments to properly monitor the System's prepaid expenses through, but not limited to, the preparation of detailed supporting schedules, otherwise, the same should not be recorded in the books;
 - d. Prepare adjusting entries to correct the errors in amortizing prepaid expenses; and
 - e. Present the portions of the prepaid expenses not likely to be consumed or realized within the succeeding year as non-current assets to comply with the requirements of PAS 1.

OTHER SIGNIFICANT AUDIT OBSERVATIONS AND RECOMMENDATIONS

1. Three lessees of the Industrial Park Management Office (IPMO) did not execute contracts with RSBS, contrary to COA Circular No. 88-282 A, while four lessees did not comply with Sections 3.3.2 and 3.3.3 of the existing lease contracts on the timely remittance of rental payments. Moreover, all the lease contracts lack provision as to the date and time of payment of the monthly management dues contributing to accumulation of receivables, thus, prejudicial to the interest of the System.
- 1.1 We recommended that Management require the Property Management and Enhancement Department (PMED) to:
- a. Execute a duly signed and notarized lease contract before turning over the property to a lessee in compliance with Article 1403 of RA No. 386 and COA Circular No. 88-282A;
 - b. Ensure that for renewals of lease contracts, a new contract should be executed either with the existing lessee or a new tenant prior to the expiration of the lease term with the former;

- c. Improve coordination with the CD to avoid discrepancies in billing and accruing monthly rentals;
- d. Strictly monitor the observance/implementation of the stipulations in the lease contracts for the benefit of the System;
- e. Impose on time the agreed penalty and interest on the delayed remittance of the four lessees; and
- f. Incorporate in subsequent lease contracts the date and time of payment of the monthly management dues and the imposition of penalties for any delay in payment thereof.

2. The BIR Registration of AFPRSBS did not include registration under the value-added tax (VAT) system, relative to the lease by RSBS of its properties, contrary to pertinent provisions of Republic Act (RA) No. 8424 or the Tax Reform Act of 1997, as amended by RA No. 9337 and Revenue Regulation (RR) No. 16-2005, thus exposing itself to possible financial and legal consequences. Further, it collected VAT from one of its lessees despite being registered as a non-VAT entity contrary also to the aforementioned law and regulation.

2.1 We recommended that Management:

- a. Register under the VAT system to comply with pertinent provisions of RA No. 8424 or present proof as to the VAT-exemption of the System, i.e. submission of VEC from the BIR;
- b. Hold in trust for PSMT Philippines, Inc. the VAT erroneously imposed on and collected from its contingent rental payments, until the System has proven that they are VAT exempt before the refund to the said contractor; and
- c. Study legal remedies to lessen the impact of possible financial and legal consequences of the non-imposition of VAT on the lease of the System's properties in current and previous years.

3. Deposits or Advances to MERALCO for the installation of new lines and/or additional facilities totaling P12.357 million from 2006 to 2014 remained unrefunded contrary to the agreements signed for the purpose, thus unfavorable to the System.

3.1 We recommended that Management:

- a. Retrieve/produce all documents relative to the deposits made including proof of accomplishments then make personal representation with MERALCO for the following:
 - The status of each service connection projects completed to determine the propriety of a refund;
 - Any offsets made to be able to update the accounts of the System.

- b. Demand payment of refund of Deposits for which the System is entitled to and update the accounts for any offsets made; and
 - c. Properly monitor the status of subsequent cash advances for service connection applications, including but not limited to annual communication with MERALCO.
- 4. Ten properties were sold at a total loss of P1.281 million without the required appraisal and public bidding prior to sale contrary to the System's Standard Operating Procedure (SOP) No. 01-13 dated June 27, 2013.
 - 4.1 We recommended that Management:
 - a. Install controls to prevent selling of properties at a loss, i.e. regular appraisal of properties and Marketing and Sales Department (MSD) verifying if the cost data used for pricing is correct/updated; or review and improve, if necessary the controls currently in place;
 - b. Study if revision of selling prices of other properties is feasible taking into account the properties' latest appraised values and current market conditions among others; and
 - c. Require the review and regular updating at least annually of the schedule of cost to be applied for each item of inventory.
- 5. Transfer Certificates of Titles (TCTs) were not yet consolidated in the name of AFPRSBS. Other deficiencies were also noted in the lists of TCTs, thus, ownership of properties cannot be ascertained, therefore the propriety and reliability of the System's Acquired Assets and Investment in Real Estate account balance amounting to P422.724 million and P6.780 billion, respectively as at December 31, 2014 is doubtful, contrary to the Conceptual Framework for Financial Reporting. Further, the System's interest and of its members are not safeguarded.
 - 5.1 We recommended that Management:
 - a. Reconcile the listed TCTs with the recorded Acquired Assets and Investment in Real Estate to ensure ownership and correctness of the account balance;
 - b. Ensure that all movement of land titles in the custody of IRMD are up to date so that at any given point in time the Inventory List can be relied upon and ascertain ownership;
 - c. Prioritize the transfer of all the TCTs in the name of AFPRSBS to safeguard its ownership and facilitate its easy disposal in the event of sale;
 - d. Correct the inaccurate information contained in the Inventory List and include therein the titles not previously reported/recorded; and

- e. Continue and fast track the process of subdividing the two lots shared with other owners and registering the same for each sole ownership.

STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

Out of the 58 audit recommendations embodied in the prior years' Annual Audit Reports, three were implemented, four were not implemented, 51 were partially implemented, two of which were reiterated in this report, while 12 similar observations were combined to shorten presentation.