AFP RETIREMENT AND SEPARATION BENEFITS SYSTEM
NOTES TO FINANCIAL STATEMENTS
(All amounts in Philippine Peso unless otherwise stated)

1. GENERAL INFORMATION

The Armed Forces of the Philippines Retirement and Separation Benefits System (AFPRSBS or the “System” for brevity) was created and duly organized under and by virtue of Presidential Decree (PD) No. 361 which was promulgated on December 30, 1973. It was established as a funding mechanism to ensure the continuous payment of retirement and separation benefits due to the members of the AFP. The System formally started its operations in 1976. To further strengthen the viability of its operations, certain provisions of PD No. 361 pertaining to membership and rate of contributions were amended by PD No. 1656 dated December 21, 1979 and PD No. 1909 dated March 22, 1984.

The Board of Trustees (BOT), consisting of 11 members with the AFP Chief of Staff as Chairman, is the policy making body of the System. The President/Chief Executive Officer, as well as the Executive Vice President/Chief Operating Officer, takes charge of the day to day affairs of the organization. As at December 31, 2016, the System has 77 regular employees, 29 casual employees and 12 contractual personnel or a total workforce of 118 personnel.

The financial statements of the System as of and for the year ended December 31, 2016 (including the comparative financial statements as of and for the year ended December 31, 2015) were authorized and approved for issue on May 26, 2017.

The registered business and office address of the System is at No. 424 Capinpin Avenue, Camp General Emilio Aguinaldo, Quezon City. It has no other offices within and outside the Philippines, except for a Satellite Office located at No. 70, Commission Civil Street corner Lincoln Street, Jaro, Iloilo City.

2. STATUS OF OPERATIONS

The System is engaged in various business operations to include the management of funds invested in the stock market, money market, government and corporate bonds, corporate loans, consumer/member loans, real estate properties, and equity holdings in subsidiaries and affiliates. 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 its lending operations, the System 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 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.

The operations of the System have been affected, and may continue to be affected, for the foreseeable future by the adverse conditions in the local and global economy characterized by the behavior of the stock market and low yield on financial instruments. For the year 2016, sales of real estate properties improved from the previous years. The disposal of some of the assets, however, is still hindered by the unavailability of the titles in the name of the System, some legal cases, and presence of illegal tenants on some of the raw lands that were acquired. As a result, the projected profits and returns from these ventures may not be fully realized. Related effects of adverse conditions, if any, will be reported in the financial statements, as they become known and measurable.

Management is implementing measures which are geared towards reducing operational costs, generating profits, and ensuring liquidity to meet the System's commitments to its customers, suppliers and stakeholders, and at the same time strengthen the overall financial position of the System.

On April 8, 2016, Memorandum Order (MO) No. 90, s. 2016 was issued by the Office of the President of the Philippines directing the abolition of the System, privatization of its subsidiaries, and for other purposes. The System was directed under Section 3 of the said MO to: (a) cease collecting members' contributions and accrual of interest thereon upon effectivity of the Order; (b) maintain such number of personnel necessary to wind-down its corporate affairs and cease the hiring of new personnel unless approved by the Governance Commission for Government Owned and Controlled Corporations (GCG); (c) collect all indebtedness due to the System; (d) continue a Corporate Operating Budget; (e) for its BOT to act as Board of Liquidators (BOL); (f) enter into contracts for the purpose of selling all its real estate assets, golf and country club shares; manage, preserve and maintain its buildings, facilities and equipment in line with the winding down activities; complete deliverables to subdivisions, and turn over completed subdivisions, and maintenance and preservation of existing projects and properties; (g) pursue activities necessary to perfect ownership of its real estate assets; (h) continue, abrogate, and/or re-negotiate existing Joint Venture (JV) Agreements/Contracts, subject to the revised National Economic and Development Authority JV Guidelines; and (i) maintain full power to sue and file complaints for the protection of the rights and interests of the corporation.

To implement the provisions of MO No. 90, the GCG shall be assisted by a Technical Working Group composed of representatives from the Department of National Defense, Department of Finance (DOF), Department of Budget and Management, Privatization Management Office, the System, and the AFP.

On April 19, 2016, pursuant to the above MO, the System's BOT already convened as BOL. The BOL approved in that meeting the stoppage of the collection of five per cent members' contributions and the accrual of interest on members' contributions effective March 31, 2016 as per Board Resolution No. SPL-01-2016. In the same meeting, the BOL also approved the continuance of the implementation of discounting of refund of Advance Refund Program to retiring military personnel with approved Order of Retirement from the AFP until the final closure of the System.

The System is still awaiting the approval of the submitted winding down plan of the System to the GCG.

The financial statements have been prepared on a going-concern basis assuming that the System will continue operating in the normal course of business, and do not include any adjustments relating to the recoverability of asset carrying values or the amount of liabilities that might result should the System be unable to continue operating in the normal course of business. The normal operation is geared towards the winding down objective of disposal/liquidation of the assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3.1. Basis of financial statement preparation

(a) Statement of compliance

The accompanying financial statements were prepared in compliance with generally accepted accounting principles in the Philippines as set forth in Philippine Financial Reporting Standards (PFRS) and Philippine Accounting Standards (PAS). PFRS are issued by the Financial Reporting Standards Council and approved by the Philippine Board of Accountancy based on International Financial Reporting Standards issued by the International Accounting Standards Board.

(b) Presentation of financial statements

The financial statements are presented in accordance with Philippine Accounting Standards (PAS) 1, *Presentation of Financial Statements.* The System presents all items of income and expenses in a single statement of comprehensive income (SCI).

(c) Basis of measurement

The financial statements are prepared on historical cost basis except for the equity securities which are measured at fair value.

(d) Accrual basis of accounting

In accordance with PAS 1, *Presentation of Financial Statements,* the financial statements, except for cash flow information, have been prepared using the accrual basis of accounting.

(e) Currency of presentation

The financial statements are presented in Philippine Peso, which is the System's functional and presentation currency. All amounts are rounded to the nearest peso, unless otherwise indicated.

3.2. Adoption of new and amended PFRSs

(a) Effective in 2016 that are relevant to the System

The System applied its accounting policies consistently to all periods presented except for the adoption of the following amendments to standards, starting January 1, 2016.

(i) PAS 1 (Amendment) – *Presentation of Financial Statements Presentation of Items of Other Comprehensive Income (effective from January 1, 2016).* The amendment encourages entities to apply professional judgment in presenting and disclosing information in the financial statements. Accordingly, it clarifies that materiality applies to the whole financial statements and an entity shall not reduce the understandability of the financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions. Moreover, the amendment clarifies that an entity's share of other comprehensive income of associates and joint ventures accounted for using equity method should be presented based on whether or not such other comprehensive income item will subsequently be reclassified to profit or loss. It further clarifies that in determining the order of presenting the notes and disclosures, an entity shall consider the understandability and comparability of the financial statements.

(ii) PFRS 7 (Amendment) – *Financial Instruments: Disclosures.* The amendment provides additional guidance to help entities identify the circumstances under which a contract to "service" financial assets is considered to be a continuing involvement in those assets for the purposes of applying the disclosure requirements of PFRS 7. Such circumstances commonly arise when, for example, the servicing is dependent on the amount or timing of cash flows collected from the transferred asset or when a fixed fee is not paid in full due to non-performance of that asset.

(iii) PAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors.* The standard requires compliance with any specific PFRS applying to a transaction, event or condition, and provides guidance on developing accounting policies for other items that result in relevant and reliable information. Changes in accounting policies and corrections of errors are generally retrospectively accounted for, whereas changes in accounting estimates are generally accounted for on a prospective basis.

(iv) PFRS 12 – *Disclosure of Interests in Other Entities.* This is a consolidated disclosure standard requiring a wide range of disclosure about an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated 'structured entities'. Disclosures are presented as a series of objectives, with detailed guidance on satisfying those objectives.

(v) PFRS 13 – *Fair Value Measurements.* This applies to PFRSs that require or permit fair value measurements or disclosures and provides a single PFRS framework for measuring fair value and requires disclosures about fair value measurement. The standard defines fair value on the basis of an “exit price” notion and uses a ‘fair value hierarchy’, which results in a market-based, rather than entity-specific measurement.

(vi) PAS 16 – *Property, Plant and Equipment.* This standard outlines the accounting treatment for most types of property, plant and equipment. Property, plant and equipment is initially measured at its cost, subsequently measured either using cost or revaluation model and depreciated so that its depreciable amount is allocated on a systematic basis over its useful life.

(vii) PAS 17 – *Leases.* This standard applies to agreement that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. The standard does not apply to agreements that are contract for services that do not transfer the right to use assets from one contracting party to the other.

(viii) PAS 18 – *Revenue.* This outlines the accounting requirements for when to recognize revenue from the sale of goods, rendering of services, and for interest, royalties and dividends. Revenue is measured at the fair value of the consideration received or receivable and recognized when prescribed conditions are met, which depend on the nature of the revenue.

(ix) PAS 24 – *Related Party Disclosure.* This standard requires a reporting entity to disclose transactions with its related parties and relationships between parents and subsidiaries irrespective of whether there have been transactions between those related parties.

(x) PAS 32 (Amendment) – *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities.* The amendment provides guidance to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. It clarifies that an entity must currently have a right of set-off that is not contingent on a future event, and must be legally enforceable in the normal course of business; in the event of default; and, in the event of insolvency or bankruptcy of the entity and all of the counterparties. The amendment also clarifies that gross settlement mechanisms (such as through a clearing house) with features that both eliminate credit and liquidity risks and process receivables and payables in a single settlement process, will satisfy the criterion for net settlement.

The amendment has been applied retrospectively in accordance with its transitional provisions. No offsetting of financial instruments has been made by the System during the year and previous years; hence, such did not have an impact on the presentation of financial assets and financial liabilities on the System's financial statements for any periods presented.

The reconciliation of the effects on the foregoing standards in prior year's financial statements resulted to no significant or material changes of the amount but resulted in a change in presentation and additional disclosures in the financial statements both in the current and prior year.

(b) *Effective in 2016 that are relevant to the System but not yet adopted*

(i) PFRS 10 – *Consolidated Financial Statements.* This standard replaces part of PAS 27 - Consolidated and Separate Financial Statements. The objective is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

(c) *Effective 2016 that are not relevant to the System*

(i) PAS 21 – *The Effects of Changes in Foreign Exchange Rates* (effective from January 1, 2016). The amendment outlines how to account for foreign currency transactions and operations in financial statements, and how to translate financial statements into a presentation currency. An entity is required to determine a functional currency (for each of its operations if necessary) based on the primary economic environment in which it operates and generally records foreign currency transactions using the spot conversion rate to that functional currency on the date of the transaction. The standard does not affect the System's financial statements since it does not have any foreign currency denominated transactions.

(ii) PFRS 2 – *Share-based Payment* (effective from January 1, 2016). This standard requires an entity to recognize share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Specific requirements are included for equity-settled and cash-settled share-based payment transactions, as well as those where the entity or supplier has a choice of cash or equity instruments.

(iii) PFRS 6 – *Exploration for and Evaluation of Mineral Resources* (effective January 1, 2016). This has the effect of allowing entities adopting the standard for the first time to use accounting policies for exploration and evaluation assets that were applied before adopting PFRSs. It also modifies impairment testing of exploration and evaluation assets by introducing different impairment indicators and allowing the carrying amount to be tested at an aggregate level (not greater than a segment).

(iv) PFRS 11 – *Joint Arrangements* (effective from January 1, 2016). The standard outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractually agreed sharing of control and arrangements subject to joint control are classified as either a joint venture (representing a share of net assets and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for accordingly).

(v) PAS 12 – *Income Taxes.* This standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. For transactions and other events recognized outside profit or loss (either in other comprehensive income or directly in equity), any related tax effects are also recognized outside profit or loss (either in other comprehensive income or directly in equity, respectively). For transactions and other events recognized directly in equity, any related tax effects are also recognized directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill arising in that combination or the amount of the bargain purchase gain recognized.

This standard also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes. The income derived from the operations of the System are tax-exempt, hence, this standard does not have any effect in the financial statements.

(vi) PAS 20 – *Accounting for Government Grants and Disclosure of Government Assistance* (effective from January 1, 2016). This outlines how to account for government grants and other assistance. Government grants are recognized in profit or loss on a systematic basis over the periods in which the entity recognizes expenses for the related costs for which the grants are intended to compensate, which the case of grants related to assets requires setting up the grant as deferred income deducting it from the carrying amount of the asset.

(vii) PAS 33 – *Earnings per Share* (effective from January 1, 2016). This sets out how to calculate both basic earnings per share (EPS) and diluted EPS. The calculation of Basic EPS is based on the weighted average number of ordinary shares outstanding during the period, whereas diluted EPS also includes dilutive potential ordinary shares (such as options and convertible instruments), if they meet certain criteria.

(viii) PAS 38 – *Intangible Assets.* The objective of this standard is to prescribe the accounting treatment for intangible assets that are not dealt with the specifically in another PFRSs/PASs. This standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

(ix) PAS 41 (Amendment) – *Agriculture-Bearer Plants (effective from January 1, 2016).* The amendment defines a bearer plant as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. On this basis, bearer plant is now, included within the scope of PAS 16 rather than PAS 41, allowing such assets to be accounted for as property, plant and equipment and to be measured after initial recognition at coast or revaluation basis in accordance with PAS 16. The amendment further clarifies that produce growing bearer plant remains within the scope of PAS 41.

(x) PFRS 4 – *Insurance Contracts (effective from January 1, 2016).* This standard applies to insurance contracts issued by any entity, including entities those unregulated as insurers. This includes both insurance and reinsurance contracts issued.

(xi) PAS 26 – *Accounting and Reporting by Retirement Benefit Plans* (effective from January 1, 2016). This standard deals with accounting and reporting by the plan to all participants as a group. It does not deal with reports to individual participants about their retirement benefit rights. This shall be applied in the financial statements of retirement benefit plans where such financial statements are prepared.

(xii) PAS 19 (Amendment) – *Employee Benefits: Defined Benefit Plans Employee Contributions* (effective from July 1, 2014). The amendment clarifies that if the amount of the contributions to defined benefit plans from employees or third parties is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method (i.e., either using the plan's contribution formula or on a straight –line basis) for the gross benefit. The amendment did not have a significant impact on the System's financial statements since the System has no defined benefit plan for its employees.

(xiii) PAS 39 (Amendment) – *Financial Instruments: Recognition and Measurement - Novation of Derivatives and Continuation of Hedge Accounting.* The amendment provides some relief from the requirements on hedge accounting by allowing entities to continue the use of hedge accounting when a derivative is novated to a clearing counterparty resulting in termination or expiration of the original hedging instrument as a consequence of laws and regulations, or the introduction thereof. AFPRSBS neither enters into transactions involving derivative instruments nor does it applies hedge accounting, the amendment did not have any impact on the System's financial statements

3.3. Revenue recognition

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

(a) Real estate sales

Real estate sales are accounted for under the full accrual method of accounting. Under this method, gross profit is recognized when: (a) the collectability of the sales price is reasonably assured; (b) the earnings process is virtually complete; and (c) the System does not have substantial continuing involvement with the subject properties.

The collectability of the sales price is considered reasonably assured when: (a) the buyers have actually confirmed the acceptance of the related loan applications after the same have been delivered to and approved by either the Home Development Mutual Fund, banks, or other financing institutions for externally-financed accounts; or (b) the full down payment required in the sales contract or comprising a substantial portion of the contract price is received and the capacity to pay and credit worthiness of buyers have been reasonably established for sales under the installment and deferred cash payment arrangement.

(b) Rental income

Rental income from investment property is accounted for on a straight-line basis over the lease term.

(c) *Interest income*

Revenue is recognized as the interest accrues taking into account the effective yield of the financial instrument or the installment receivable from real estate sales.

(d) *Gain from sale of investment*

Revenue is recognized upon consummation of the sale transaction. Under this method, gross profit is recognized when: (a) the collectability of the sales price is reasonably assured; (b) the earnings process and sales documentation are virtually complete; and (c) the System does not have substantial continuing involvement with the subject investment.

(e) *Dividend income*

Dividend income is recognized when the right to receive payment is established.

3.4. Cash and cash equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amount of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

3.5. Financial assets and liabilities

Financial assets are classified in the following categories at initial recognition based on the purpose for which they are acquired:

(a) *Financial assets held for trading*

A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term or, if so designated by the System. Assets in this category are classified as current and booked under short-term investments if they are either held for trading or are expected to be realized within 12 months as of the statement of financial position date.

(b) *Loans and receivables*

Loans and receivables are stated at the outstanding balance reduced by an allowance for doubtful accounts. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are classified as non-current assets except for those reclassified under the current portion.

Unearned interest is amortized to income over the term of the loan, using the interest method. Interest on loans is accrued as earned.

Allowance for doubtful accounts is based on Management's evaluation of the collectability of loans and prior loan loss experience. This allowance is established through a provision charged to expense. Loans are written-off against the allowance for doubtful accounts when the collectability of the principal is unlikely.

(c) *Held-to-maturity (HTM) investments*

HTM investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the AFPRSBS intends and is able to hold to maturity.

(d) *Available-for-sale (AFS) financial assets*

AFS financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the System intends to dispose of the investment within 12 months from the statement of financial position date.

(e) *Impairment of financial assets*

The System assesses at each statement of financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of loans and receivables, the allowance for doubtful accounts is based on Management's evaluation of the collectability of loans and prior loan loss experience. The AFPRSBS policy on the provision for allowances, however, is currently being reviewed. Any proposed provision is being presented to the BOT now BOL through proper channels on case to case basis.

3.6. Supplies and materials inventory

Supplies and materials inventory are valued at cost determined on a moving average basis.

3.7. Investments in shares of stock

Investments in subsidiaries and associates are accounted for under the equity method or cost method depending on whether the System has significant influence or not. Under the equity method, the System recognizes in its statements of income, its equity in the net earnings or losses of subsidiaries and associates since dates of acquisition. The difference between the System's cost of such investments and its proportionate share in the underlying net assets at dates of acquisition is amortized using the straight-line method for a period of 20 years. Dividends received are credited to the investments account.

An allowance is set up for any substantial and presumably permanent decline in the carrying values of the investments in shares of stock.

The System does not prepare consolidated financial statements as required by generally accepted accounting principles in the Philippines since majority of the audited financial statements of the System's subsidiaries are not available because they are either closed or have ceased operations.

3.8. Investments in real estate

Investments in real estate are carried at cost and presented in the statement of financial position. Expenditures for acquisition, borrowing costs, development, construction, maintenance and improvements involving the System's real estate properties are capitalized as part of the cost of investment in real estate. The maintenance costs are capitalized until such time that the System starts to sell the inventories or up to the time the book value is already equal to the fair market value.

The System's member-related projects, which consist of on-base housing units under lease-purchase arrangement with the AFP, are depreciated using straight-line method over their estimated useful lives at an average of 25 years.

3.9. Investment property

Investment property consists of the cost of buildings and building improvements constructed inside the System's Industrial Park located in Taguig City, Metro Manila. The buildings constructed are being leased at competitive rental rates to private companies. The System does not own the land but has acquired perpetual rights from the Philippine Government to use the property for its own use and purpose.

The investment account is carried at cost less any accumulated depreciation and any impairment in value. The asset was depreciated using the straight-line method over its estimated useful life. The average useful life of the asset is 20 years.

3.10. Property and equipment

Property and equipment are stated at cost less accumulated depreciation and amortization and any impairment in value. The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition and to its location for its intended use.

Expenditures incurred after the property and equipment have been put into operations, such as repairs and maintenance, are normally charged to expenses in the period the costs are incurred. When assets are sold, retired or otherwise disposed of, the cost and related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is credited or charged to current operations.

Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets as follows:

Assets	Estimated Useful Life
Buildings and improvements	10 years
Transportation equipment	5 years
Office equipment	3 years
Office furniture and fixtures	3 years

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

In 2003, the Commission on Audit issued COA Circular No. 2003-007 dated December 11, 2003 which provides policies and guidelines on the computation of depreciation charges for government property, plant and equipment as well as the provision of residual value equivalent to 10 per cent of the acquisition cost/appraised value of the asset. Depreciation is calculated using the straight-line method based on the following estimated useful lives of the assets:

Assets	Estimated Useful Life
Building and improvements/land improvements	10 – 30 years
Furniture and equipment, computer hardware	5 – 10 years
Machinery and equipment	10 years
Transportation equipment (motor vehicle)	7 years

The System has adopted said COA Circular for acquisitions beginning 2011. The acquisitions made prior to 2011 were not yet adjusted due to certain limitations in the existing computerized fixed assets inventory monitoring system. This will be implemented as soon as the required enhancements are done, if still feasible.

3.11. Acquired assets

Assets acquired in full or partial settlement of loans are recorded at the book value or bid price, whichever is lower. Holding costs subsequent to the foreclosure, acquisition or consolidation of the properties are charged to operations if the book value is already equal or higher than the market value. These assets are shown under either "Investments in real estate" or "Other assets" account, depending on Management's intention.

An allowance for probable losses is set up for any anticipated significant decline in value of the property based on the appraisal reports and current negotiations and programs to dispose of these properties to interested parties.

3.12. Provisions

Provisions are recognized under the following conditions: (a) when the System has a present obligation, whether legal or constructive, as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation.

In prior years, provisions for contingencies were accrued when it is probable that a liability had been incurred at statement of financial position date and the amount can be reasonably estimated. Otherwise, the loss contingency was disclosed only.

3.13. Contingencies

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

3.14. Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

3.15. Events after the reporting date

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

4. CASH AND CASH EQUIVALENTS

This account consists of the following:

	2016	2015
Cash on hand	**565,975**	292,422
Cash in banks	**59,226,374**	104,029,976
Cash equivalents	**529,000,000**	13,000,000
	588,792,349	117,322,398

Cash in banks earn interest at the respective bank deposit interest rates. Cash equivalents consist of money market placements and other fixed-income securities with maturities of three months or less and which earn interest at the respective short-term deposit interest rates.

As of December 31, 2016, a total deposit of P1,379,041 by the System with a bank in its Camp Aguinaldo Branch was put on hold by said bank by virtue of a Notice of Garnishment from the Housing and Land Use Conversion Regulatory Board as a result of the case filed by some Village East III buyers, against one of the System's JV partner. A Notice of Resolution/Order was already issued granting the System Motion to Quash and lifting the garnishment made by the Sheriff. The System has already provided the bank a copy of the Notice of Resolution/Order thru its letter dated February 17, 2017. To-date, the System is still awaiting for a written reply from the said bank.

For the year 2015, the System recognized a liability in the books amounting to P45,656,843.29 as a result of the garnishment of the System's deposits with the bank due to the civil case that was filed by a Developer against Matrix Realty and Development Corporation (MRDC), a closed subsidiary of AFPRSBS. Although the

System is not a party to the case, it was made liable for the judgment obligation of MRDC by virtue of the Alias Writ of Execution dated August 6, 2015 and the Order issued on May 7, 2015 piercing the veil of corporate fiction of MRDC, both issued by the Quezon City RTC Branch 93. On January 22, 2016, the Branch Manager of the Aurora Boulevard – Notre Dame, Quezon City Branch of said bank issued Manager's Check with the same amount in favor of the complainant Developer. The inclusion of the provision for garnishment loss in the financial statements for 2015 was approved by the BOT in its February 15, 2016 meeting.

The decision of Quezon City RTC Branch 93 was appealed by the System in the Court of Appeals (CA). The CA thru a Notice of Judgment dated May 31, 2016 decided in favor of the AFPRSBS - that the System is not liable to the said civil case. Subsequently, said Developer filed a Motion for Reconsideration (MR) with the CA on June 22, 2016. As of March 2017, the MR is still for resolution.

5. SHORT-TERM INVESTMENTS – NET

This account consists of the following:

	2016	2015 (As restated)
Marketable securities	**755,041,584**	2,834,965,402
Allowance for decline in value	**-**	(13,465,402)
	755,041,584	2,821,500,000

Marketable securities include money market placements that earn interest at quoted rates ranging from 1.25 per cent to 2.00 per cent per annum, and various traded stock investments.

6. RECEIVABLES – NET

This account consists of the following:

	2016	2015 (As restated)
Receivable from sale of real estate properties in JV projects	**5,213,860**	5,213,860
Receivable from JV partner *(See Note 28)*	**16,242,192**	11,717,792
Accrued interest on loans and investments	**57,187,386**	52,654,956
Non-trade receivables	**16,154,550**	16,154,550
Receivable from employees/others	**5,228,487**	5,318,666
Advances to contractors	**1,750,452**	1,750,452
Management fees *(See Note 28)*	**3,073,074**	3,073,074
Other receivables	**484,551,790**	164,040,519
	589,401,791	259,923,869
Allowance for doubtful accounts	**(73,879,623)**	(73,879,623)
	515,522,168	186,044,246

Receivable from JV partner includes collections made by various JV partners and the regrouping of Installment contracts receivable (ICR) – current to ICR Past due particularly Village East III accounts totaling to P21.698 million and Eastridge accounts totaling to P9.342 million.

Other receivables include receivables from Industrial Park lessees and advances to employees and suppliers. The increase in the account pertains to the System's setting up of the receivable from the persons liable amounting to P266.589 million resulting in the audit disallowance and charge which have become final and executory under Supreme Court (SC) Decision in GR No. 217948 dated January 12, 2016. Accordingly, a Notice of Finality of Decision and COA Order of Execution were issued.

The above also includes interests that were accrued on various commercial papers whose interests are payable, quarterly, annually, or upon maturity.

7. LOANS RECEIVABLE – NET

This account consists of the following:

	2016	2015 (As restated)
Short-term loans	**333,837,197**	542,993,210
Medium-term loans *(See Note 28)*	**49,624,818**	50,212,184
Past due loans	**127,006,747**	593,129,271
Accounts under litigation	**526,062,169**	60,131,069
	1,036,530,931	1,246,465,734
Allowance for doubtful accounts	**(349,823,950)**	(349,823,950)
Unearned interest income	**(117,267,326)**	(117,267,326)
	569,439,655	779,374,458
Current portion of short-term and medium-term loans	**(383,462,015)**	(593,205,394)
	185,977,640	186,169,064

Short-term loans represent the various types of loans extended by the System to its members like the advance refunds and the multi-purpose loans. These loans bear interest rates comparable to the prevailing market rates. After the issuance of MO No. 90 on April 8, 2016, the System stopped the granting of all loans to members except the advance refunds.

Medium-term loans represent outstanding balances of loans granted by the System to its members and employees and some private companies.

Past due loans represent uncollected balances of loans that remained unpaid for more than 180 days. These loans, including accounts under litigation, are secured by mortgages on real estate, except on a few accounts.

8. OTHER CURRENT ASSETS

This account consists of the following:

	2016	2015 (As restated)
Prepaid supplies and materials	916,508	927,302
Prepaid insurance	485,876	491,126
Prepaid subscriptions/membership	368,360	368,360
Prepaid tax	11,736,769	13,042,575
Prepaid commissions	17,711,048	4,771,344
Prepaid repairs and maintenance	295,847	-
	31,514,408	**19,600,707**

Prepaid insurance pertains to the payments made for insurance premium of the System's properties which are being amortized over the covered period.

Advance payments for real estate taxes for the various properties of RSBS were also included in this category classified as Prepaid taxes.

Prepaid commission pertains to the partial payments of commissions to brokers/ marketing agents relative to the sale of the System's real estate inventories.

Prepaid repairs and maintenance pertains to the remaining unamortized cost for maintenance support services with hardware upgrade for the System's existing firewall/VPN Appliance and for the server maintenance service support for the existing IBM System and Servers.

9. NON-CURRENT INVESTMENTS – NET

This account consists of the following:

	2016	2015 (As restated)
Marketable securities	**21,919,222**	21,457,295

Included in this category is the restricted Money Market Placement with a bank in the amount of P2,991,092 which was used as collateral in the pending case with Department of Labor and Employment. The System is a respondent to the labor case filed by the employees of a security agency which contracted its services with the System. As of to date, the System is still awaiting for the result of the petition.

The account also includes the Available For Sale financial assets in the total amount of P18,928,130 which is inclusive of the cumulative unrealized gain on financial assets in the amount of P10,732,428. The cumulative unrealized gain is also presented in the SCI.

10. INSTALLMENT CONTRACTS RECEIVABLE – NET

This account consists of the following:

	2016	2015 (As restated)
ICR from sale of real estate inventory	**518,485,272**	448,423,221
ICR from sale of acquired assets	**4,148,591**	4,148,591
Past due ICR	**166,321,928**	179,291,747
	688,955,791	631,863,559
Allowance for doubtful accounts	**(165,323,009)**	(165,323,009)
	523,632,782	466,540,550

ICR accounts represent the balances of contract receivables arising from the sale of real estate inventories and acquired assets which were financed by the System through in-house financing scheme. The receivables are collectible within a period of one to 15 years with interest at prevailing market rates. The transactions are covered by contracts to sell. Corresponding titles to the real estate sold are transferred to the buyers only upon full payment of the contract price.

Past due ICRs represent the uncollected balance that remained unpaid for more than 180 days.

11. ADVANCES TO SUBSIDIARIES AND ASSOCIATES – NET

This account consists of non-interest bearing cash advances to the following subsidiaries of the System:

	2016	2015
Bay Resources Development Corporation (BRDC)	**13,191,805**	9,179,341
Matrix Realty and Development Corporation (MRDC)	**5,894,093**	5,894,093
Monterrosa Development Corporation (MDC)	**12,136,245**	11,858,745
Veterans Electronics Communications, Inc. (VECI)	**1,768,761**	1,768,761
Public Securities Corporation	**1,420,991**	1,420,991
Others	**659,520**	659,520
	35,071,415	30,781,451
Allowance for doubtful accounts	**(17,837,110)**	(17,837,110)
	17,234,305	12,944,341

A 100 per cent allowance was already provided for advances to subsidiaries which have closed and ceased operations, such as the VECI and the MRDC. Allowances were also provided for advances that remained uncollected for more than a year.

On the other hand, the audited financial Statements of BRDC as of December 31, 2013 reflected a liability to AFPRSBS representing interest amounting to P10,210,717 for the advances that it acquired from the System in previous years. The amount is in addition to the amount reflected as advances in the System's books. The same were not reflected yet in the books of the System pending submission of the relevant supporting documents.

12. INVESTMENTS IN SHARES OF STOCK – NET

Investments in shares of stock which are booked under the equity method, consist of the following:

	Percentage of Ownership	2016	2015 (As restated)
Acquisition cost			
Monterrosa Development Corporation	100.00	**873,927,445**	873,927,445
Marilaque Land, Inc. (MLI)	40.00	**609,000,000**	609,000,000
Bay Resources Development Corporation	50.00	**402,000,000**	402,000,000
Philippine Airlines (PAL)	00.31	**500,000,000**	500,000,000
Amtrust Holdings, Inc.	25.56	**127,000,000**	127,000,000
Resources Investment House	100.00	**102,123,549**	102,123,549
Advent Capital and Finance Corporation	14.02	**71,183,811**	71,183,811
RSBS Land, Inc. (RLI)	100.00	**994,170**	994,170
Aguinaldo Theater Enterprises, Inc.	50.00	**120,000,000**	120,000,000
Veterans Electronics Communications, Inc.	90.65	**56,738,598**	56,738,598
Veterans Electronics Communications, Inc.	90.65	**70,000,000**	70,000,000
Matrix Realty Development Corporation	100.00	**35,931,250**	35,931,250
Goodfit Manufacturing Corporation (GMC)	79.99	**25,556,920**	25,556,920
Fashion Link Corporation (FLC)	100.00	**20,100,000**	20,100,000
First Dominion Prime Holdings, Inc.	00.93	**15,418,269**	15,418,269
Globan Fruits and Development Corporation (GFDC)	100.00	**10,000,000**	10,000,000
Southern Utility Management and Services, Inc.	100.00	**10,000,000**	10,000,000
CEMX, Inc.	24.00	**6,000,000**	6,000,000
General Satellite Communications, Inc. (GSC)	62.00	**2,906,238**	2,906,238
RSBS Enterprises, Inc. (REI)	100.00	**2,500,000**	2,500,000
Cyquest, Inc.	40.00	**2,000,000**	2,000,000
		3,063,380,250	3,063,380,250
Net adjustments			
Accumulated equity in net losses, beginning		**(530,303,822)**	(533,391,766)
Adjustment of prior year share in Net Earnings		**(503,397)**	1,950,000
Equity in net earnings (losses) for the year		**2,252,119**	1,137,944
Accumulated equity in net losses, ending		**(528,555,100)**	(530,303,822)
Cumulative liquidating dividends - SUMSI		**(11,500,000)**	(9,500,000)
Deferred income		**(196,508,125)**	(196,430,111)
Allowance for decline in value		**(946,616,466)**	(946,616,466)
		(1,683,179,691)	(1,682,850,399)
		1,380,200,559	1,380,529,851

Deferred income represents the System's 40 per cent share in the unrealized gain arising from the transfer in 1995 of certain real estate property of the System to MLI in exchange for the latter's shares of stock.

On October 22, 2014, RLI officially obtained an approval from the Securities and Exchange Commission (SEC) shortening the term of its existence thereby dissolving the corporation as of said date. In July 2015, the Notes Payable by the System to RLI of P40.40 million and the corresponding accrued interest expense of P16.59 million in the System's books were already closed to the balance of the investment recorded in the said subsidiary after Management approved the turnover/transfer of the receivables of the dissolved subsidiary to the System. The System is already in the process of closing the remaining RLI investment in its books and the corresponding adjustment will be made upon approval by Management.

The other subsidiaries and associates which have closed and/or ceased operations are the GMC, FLC, GFDC, CEMX, Inc., GSC, REI and Cyquest, Inc. Some of these companies have not been formally dissolved pending completion of certain documentary requirements of the SEC and the Bureau of Internal Revenue (BIR).

In 2014, the System booked an additional allowance of P19,878,646.60 as a result of the reduction in the par value of the PAL shares from P0.80 to P0.20 per share, bringing the net investment balance of PAL down to P6,626,215.53 as of the end of 2014 and up to this date.

13. INVESTMENTS IN REAL ESTATE - NET

This account consists of the following:

	2016	2015 (As restated)
Landbanking assets	**3,286,794,884**	3,294,976,850
Commercial and residential subdivision projects	**3,060,350,209**	3,334,439,162
Member-related housing projects	**74,238,404**	73,701,139
Golf and country club shares	**133,318,138**	133,908,690
	6,554,701,635	6,837,025,841
Allowance for decline in value of investment in real estate	**(112,362,251)**	(109,661,814)
	6,442,339,384	6,727,364,027

Landbanking assets refer to undeveloped real estate properties of the System located in various parts of the country. These assets are being offered for sale to the public.

Commercial and residential subdivision projects represent the real estate projects which were developed either by the System or under a JV arrangement with reputable real estate developers. These projects include residential estates, memorial parks, golf courses and commercial areas. The System sells its inventories from these projects through accredited marketing companies and real estate brokers.

Member-related projects represent the condominium and apartment units in various AFP camps which were built by the System. These units are being leased by the AFP to qualified AFP officers and enlisted personnel whose quarters allowance are being used to pay for the monthly rentals. The rental fees being remitted by the AFP to the System are being charged as income.

Golf and country club shares represent the System's shareholdings in golf clubs and sports and country clubs. These clubs were built inside the premises of the System's commercial and residential subdivision projects and serve as additional amenities of the project. The System exercises the voting rights of the shares during the annual stockholder's meeting of the club.

As of December 2016, there are still possible remaining deliverables of the System to the Riviera Golf Club, Inc. and Riviera Sports and Country Club, Inc.

14. INVESTMENT PROPERTY – NET

This account consists of the following:

	2016	2015 (As restated)
Building and building improvements at the Industrial Park	**122,661,551**	122,661,551
Accumulated depreciation	**(107,862,572)**	(107,862,572)
Direct cost, net of amortization	**5,856,000**	6,112,000
	20,654,979	20,910,979

In 2014, the System executed a contract with HMRID Property Inc. for the lease of a 40,000.00 sqm open space located in the System's Industrial Park. The term of the lease is for a period of 25 years for a monthly rental of P800.00 per square meter or a total of P3,200,000.00. The System incurred a direct cost of P6.4 million for the lease of the said property which was added as part of the cost of the project to be amortized monthly over the term of the lease in accordance with PAS 17 - Leases.

For 2016, the System recorded the contingent rent amounting to P9.3 million for the lease of two parcels of land in Aseana Business Park to PSMT Philippines, Inc.

The following is a schedule by years of minimum rentals on the System's significant operating leases as of December 31, 2016:

	HMRID	**PSMT**	**Total**
2017	40,864,000	3,051,046	43,915,046
2018	41,088,000	3,051,046	44,139,046
2019	43,724,480	3,051,046	46,775,526
2020	43,964,160	3,051,047	47,015,207
2021	46,785,194	3,051,047	49,836,241
Later years	1,170,250,372	6,102,092	1,176,352,464
	1,386,676,206	**21,357,324**	**1,408,033,530**

The System used the year-end exchange rate of P49.813 in estimating the minimum future rental payments for PSMT.

15. PROPERTY AND EQUIPMENT - NET

This account consists of the following:

	Building Improvements	Office Equipment	Transportation Equipment	Furniture and Fixtures	Total
Cost					
Balance, 1/1/2016	91,429,579	148,786,772	8,283,853	15,680,872	264,181,076
Additions (Deductions)	-	430,410	-	33,600	464,010
Balance, 12/31/2016	91,429,579	149,217,182	8,283,853	15,714,472	264,645,086
Accumulated depreciation and amortization					
Balance, 1/1/2016	82,286,621	126,654,742	7,175,811	12,248,132	228,365,306
Depreciation/amortization	-	2,069,758	237,225	96,864	2,403,847
Balance, 12/31/2016	82,286,621	128,724,500	7,413,036	12,344,996	230,769,153
Net book value, 12/31/2016	**9,142,958**	**20,492,682**	**870,817**	**3,369,476**	**33,875,933**
Net book value, 12/31/2015	**9,142,958**	**22,132,030**	**1,108,042**	**3,432,740**	**35,815,770**

The System’s Internal Appraiser under the Office of Special Concerns (OSC) conducted an investigation and appraisal of the System’s owned buildings and improvement located at the System’s Compound and the report was contained under Disposition Form dated July 11, 2016. Based on the investigation and analysis of all factors, OSC puts the fair market value of the properties appraised consisting of 15 structures/improvements subject to the attached limiting conditions at P33,569,000.00. The System, however, is using cost method in the recording of its properties and equipment.

16. INVESTMENT IN BONDS

This account consists of the following:

	2016	2015 (As restated)
Treasury bonds	**4,367,629,158**	2,875,665,644
Development Bank of the Philippines (DBP) long-term commercial paper (LTCP)	**500,000,000**	500,000,000
Landbank of the Philippines (LBP) LTCP	**300,000,000**	300,000,000
First Gen Corporation	**50,000,000**	50,000,000
Retail treasury bonds	**50,000,000**	50,000,000
	5,267,629,158	3,775,665,644

The investments earn an average yield of 3.209 per cent interest per annum with terms ranging from two to 10 years.

On August 6, 2015, the System requested confirmation from the DOF to use private banks/financial intermediaries as broker for the trading of the System’s government securities under the Non-Restricted Trading System (NRTS) pursuant to DOF's Department Order No. 068-2014. The System's request, however, was denied by DOF in its letter dated February 10, 2016. The System was advised to utilize the services of LBP and DBP for the proposed treasury investment activities since both government financial institutions are also eligible brokers under the NRTS. The investment with First Gen. Corporation was made on July 25, 2011, prior to the receipt of DOF's letter to the System. The investment yields interest of eight per cent and will be held-to-maturity by the System up to July 25, 2018.

17. OTHER NON-CURRENT ASSETS – NET

This account consists of the following:

	2016	2015 (As restated)
Acquired assets *(See Note 3.11)*	**497,287,205**	500,919,561
Allowance for probable losses	**(38,960,432)**	(40,401,176)
	458,326,773	460,518,385
Deposits and others	**8,901,380**	8,462,880
	467,228,153	468,981,265

Acquired assets include residential lots, memorial lots, condominium units, machineries and equipment which the System foreclosed to satisfy outstanding unpaid balances of loans granted to various companies and individuals.

The acquired assets include five condominium units that were used as security for the counter attachment bond applied by MRDC. As of February 2016, the System has already requested the Office of the Government Corporate Counsel (OGCC) in its letter dated February 23, 2016 to undertake the release/cancellation of the mortgage on the subject condominium units considering that the judgment amount in the civil case between MRDC and a Developer has been fully satisfied. The same was reiterated by the System to OGCC in its letter dated February 21, 2017.

18. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

These accounts consist of the following:

	2016	2015 (As restated)
Trade payables	**143,574,514**	142,731,654
Non-trade payables	**174,035,429**	190,154,974
Reserve for real estate development	**35,841,350**	50,890,172
Accrued employee benefits	**78,237,531**	56,162,028
Accrued operating expenses	**28,639,023**	27,944,376
Retention payable	**21,964,910**	23,198,072
Payable to real estate brokers	**18,242,245**	13,494,283

	2016	2015 (As restated)
Payable to landowners	**6,851,650**	6,851,650
Buyer's refund payable	**1,266,122**	1,427,575
Other payables	**10,420,031**	9,296,849
	519,072,805	522,151,633

Trade payables account includes the remaining payables to various tenants for the lot acquisitions made for the Riviera rawlands in the previous years and the balance for the acquisition of Lot-X of the General Santos property.

Non-trade payables include the set-up for the P45.656 million garnished deposits that was paid to a complainant Developer as a result of the civil case filed against MRDC *(See Note 4).*

Reserve for real estate development account is composed of the remaining liabilities of the System to its various contractors and the estimated costs to complete the Sta. Rosa Homes Subdivision and San Lorenzo South Subdivision (SLSS) projects of the System. The amount of estimated costs to complete that was included in the said account is being reviewed periodically to assess the sufficiency of the estimates and to account for other costs that may arise in the course of completing the projects.

For 2016, a total of P16.464 million were paid to contractors representing either partial or full payment for the completion of various projects that were undertaken at Riviera, Villa Segovia, Villa De Toledo, and SLSS projects.

Included in the accrued employee benefits are the accruals made for the provision for employee separation benefits in the total amount of P25.895 million, of which, P9.002 million pertains to accruals for 2016. There is also an accrual for the provision for salary increase for 2016 amounting to P12.849 million.

19. MEMBERS' CONTRIBUTIONS PAYABLE

This account pertains to estimated amount of refund of contributions payable to retiring members of the AFP within a one-year period. In April 2016, however, the contributions lodged in the equity portion, those that will not be paid within one-year, were all reclassified to liability as recommended by COA. The transfer was made since the contributions of the members are all due for refund upon their retirements.

20. DEPOSITS AND OTHER LIABILITIES

This account includes interest collected but not yet earned from certain investments and deposits received from installment buyers of real estate properties prior to completion of the required down payments and those amortizations that are not yet applied in the subsidiary ledgers of the respective buyers.

21. ESTIMATED LIABILITY ON EARNINGS OF MEMBERS' CONTRIBUTIONS

Movements in estimated liability on earnings of MCs are as follows:

	2016	2015
Balance at beginning of year	**3,925,080,978**	3,464,187,734
Transfer from Retained earnings	**-**	643,600,040
Payments made	**(161,979,308)**	(182,706,796)
Balance at end of year	**3,763,101,670**	3,925,080,978
Current portion	**(256,148,622)**	(198,183,228)
	3,506,953,048	3,726,897,750

The System started granting four per cent interest on MCs as per SOP No. 11-92 which shall be compounded yearly effective January 1992 and that will accrue up to the time the member retires or is separated from the service. The interests will be paid out together with the refund of MCs to the System. Effective January 1996, the interest on MCs was increased to six per cent per annum compounded annually.

In November 2010, the BOT approved the adoption of simple interest per annum on MCs from 1992 onwards. The approval is effective to those who will retire from January 2011 onwards.

The System reviews periodically the computed estimated liability on earnings of MCs in order to reflect the latest estimates of accumulated earnings thereon. The yearly interest accruals are being charged against the Retained earnings.

The current portion of estimated liability on earnings of MCs is based on the actual cash payments made during the year plus the average increase per year.

In April 2016, the System stopped computing for interests on MCs in compliance with the provision of MO No. 90 providing for the abolition of the System. For the period January to March 2016, a total amount of P169.391 million was accrued as interests earned on MCs and were charged to the current operations of the System as finance cost under the investment expenses category.

22. FUND EQUITY

Pursuant to PD No. 361, the System was established for the purpose of providing a separate fund or scheme to ensure payment of retirement and separation benefits to the members of the AFP.

Accordingly, the System was funded mainly through the following: (a) appropriation remitted by the Philippine Government, the total commitment of which amounted to P200 million; (b) the contributions from officers and enlisted personnel in the active service which was pegged at four per cent of their basic and longevity pay; and (c) income from investment operations.

On December 21, 1979, PD No. 1656 was promulgated amending certain provisions of PD No. 361. Under PD No. 1656, the fund of the System shall be allowed to grow to be able to provide perpetually the cash requirement covering the retirement and separation benefits payment to military members of the AFP on a self-sustaining basis. Prior to the time when perpetual self-sufficiency of the fund is attained as determined by actuarial valuation, the yearly requirement for the retirement and separation benefits of military personnel as provided by RA No. 340 as amended, PD No. 1638, as amended by PD No. 1650, and such other similar laws as may be enacted, shall be included in and funded out of the annual appropriations for the AFP.

Pursuant to PD No. 1656 amending Section 4 of PD No. 361, the rate of MCs became five per cent of basic pay effective January 1, 1980. The total contributions including the earned interest shall be refunded in lump sum to the officer or enlisted personnel upon separation or retirement from military service.

On March 22, 1984, PD No. 1656 was further amended by PD No. 1909, which considered military personnel who retired from the active service prior to September 10, 1979 and are receiving annual retirement pension from the AFP, as additional members of the System. Hence, they have been required to contribute an amount equivalent to five per cent of their gross monthly pension as adjusted pursuant to PD No. 1909. On December 17, 1990, it was ruled that their contributions shall be stopped upon reaching the age of 65 when they become entitled to the refund of their accumulated contributions.

Further, under PD No. 1909, the System shall support the payment of the increase in pension rate of retired personnel prior to September 10, 1979. This is for the purpose of aligning the prevailing pay scale of the officers and enlisted men in active service so that they will be given the same means and support as those who recently retired to meet the increasing cost of living and demand for better social and economic life. Such equalization was initially funded from savings out of the P200 million AFP appropriation mentioned above, and it had been incorporated subsequently into the AFP's annual budget for pension.

On August 12, 2003, the SC declared the System as a government entity and that its funds are in the nature of public funds. The decision became final and executory on December 10, 2003. The SC likewise stated that the System was created by PD No. 361 whose purpose and function are similar to those of Government Service and Insurance System and Social Security System.

In April 2016, the System has already reclassified the members' contributions as part of its liabilities (previously treated as equity) in the 2016 Financial Statements. The said contributions are being refunded as they fall due as embodied in the issued MO No. 90.

As of December 31, 2016, the remaining Fund Equity of the System is composed of the P200 million government contributions, retained earnings of P990 million and other comprehensive income of P0.552 million representing the cumulative income on changes in fair value of stocks.

23. MEMBERS' CONTRIBUTIONS

MCs are stated based on the remittance reports on actual deductions from the compensation of officers and enlisted personnel in the active service. This account also includes contributions from the retirees covered by PD No. 1909, which is equivalent to five per cent of their gross monthly pension. However, no new contributions are being received from the retirees covered by PD No. 1909. The last contribution received by the System from the retirees was in November 2014.

On April 19, 2016, the BOL approved the stoppage of the collection of five per cent MCs effective March 31, 2016 as per Board Resolution No. SPL -01-2016. Hence, no new contributions were received by the System, except for some supplementary contributions pertaining to prior months *(See Notes 19 and 21).*

24. REVENUES

Revenues consist of the following:

	2016	2015
Fund management operations		
Interest on MMP/deposit in banks	40,185,859	54,909,901
Income from Long-term investments	154,373,411	121,345,311
Income from stocks/Dividends	714,435	6,235,010
	195,273,705	182,490,222
Lending operations		
Interest on commercial loans	2,437,437	2,406,942
Interest on ICRs	25,387,917	20,339,557
Interest on employee loans	756,414	756,044
Interest on advance refunds	14,163,178	13,929,810
Interest on multi-purpose loans	150,800	299,795
Interest on discounting of commutation of leave	339,667	1,927,256
Other income	7,023,905	4,567,511
	50,259,318	44,226,915
Real estate rentals		
Rentals from IPMO - net	110,663,389	107,902,333
Rentals from real estate properties - net	24,488,009	12,799,456
	135,151,398	120,701,789
Real estate operations		
Sale of real estate inventories - net	185,425,985	82,619,355
Income from acquired assets - net	7,885,146	8,786,821
Other income	5,192,792	4,040,524
	198,503,923	95,446,700
Equity holdings in subsidiaries and associates	2,252,119	1,137,943
	581,440,463	**444,003,569**

25. DEPRECIATION AND AMORTIZATION

This account consists of the following:

	2016	2015
Property and equipment	**2,403,847**	3,379,552
Investments in real estate	**2,700,437**	2,700,437
	5,104,284	6,079,989

26. OTHER REVENUES

This account mainly consists of recoveries from defaulting loan accounts, fines and penalties from accounts in default, forfeiture of payments from cancelled sales contracts, dividends, and interest income.

27. EMPLOYEE BENEFITS

Included in the accrued employee benefits are the accruals made for the provision for employee separation benefits in the total amount of P25.895 million, of which, P9.002 million pertains to accruals for 2016. There is also an accrual for the provision for salary increase for 2016 amounting to P12.849 million.

28. RELATED PARTY TRANSACTIONS

The System enters into various transactions with its subsidiaries, associates and JV partners. Significant transactions with subsidiaries, associates and JV partners consist of non-interest bearing cash advances, interest bearing loans receivable and payables.

The year-end balances in respect of related parties included in the financial statements are as follows:

	2016	2015
Receivables *(See Note 6)*	**3,073,074**	3,073,074
Receivable from joint venture partner *(See Note 6)*	**16,242,192**	11,717,792
Loans receivable *(See Note 7)*	**49,624,818**	50,212,184
Advances to subsidiaries and associates *(See Note 11)*	**35,071,415**	30,781,451
Accounts payable and accrued expenses	**80,006,961**	56,976,127
	184,018,460	152,760,628

29. CONTINGENCIES

The System was summoned by the Senate Committees on Accountability of Public Offices and Investigation (Blue Ribbon) and National Defense and Security, joined by the Joint Committees on Banks and Financial Institutions and Currencies and National Defense and Security, for an investigation regarding the deterioration of the System's financial condition and alleged discrepancies in the purchase price of certain real estate acquisitions.

A final report was subsequently submitted by the Joint Committees recommending, among others, the establishment of a conservatorship committee to preserve the System's assets, the further actuarial study of the System's financial condition, the passage of a law revising or creating a new System charter, and the prosecution or censure of former or current officers of the System.

Various lawsuits, claims and proceedings, including an action filed for the cancellation of titles of certain properties, have been or may be instituted or asserted against the System. While the amounts may be substantial, the ultimate liability cannot presently be determined because of the considerable uncertainties that exist. Therefore, it is possible that results of operations or liquidity in a particular period could be materially affected by certain contingencies.

However, based on facts currently available, Management believes that the disposition of matters that are pending or asserted will not have a material effect on the financial position of the System.

30. PRIOR PERIOD ADJUSTMENT

The Retained earnings was presented as net of prior period adjustments to reflect sales and expense transactions of prior years. For the year 2016, the System has already stopped the charging of the interests earned by the contributions of the members from the Retained earnings. The interests earned by the contributions of the members for the month of January to March 2016 amounting to P169.391 million were directly charged to the current year's income as recommended by COA. The transfer of Retained Earnings amounting to P643.600 million to estimated liability on earnings of MCs was adjusted to restate the 2015 balance in the SCI. The accrual of interest on MCs is only until March 2016 as approved by the System's BOL in April 2016.

The correction/adjustment of prior years' errors consists of the following: (a) unrealized gains from available-for-sale of P16.566 million; and (b) adjustments on the Retained Earnings account which represent various income from lending operations and real estate operations and other expenses amounting to P16.623 and P122.480 million as presented in the statement of changes in equity.

31. EXEMPTION FROM TAX

Pursuant to Section 2(c) of PD No. 361, as amended by PD No. 1656, all earnings of the System shall not be subject to any tax whatsoever. The System has likewise secured an affirmation of its tax exemption from the BIR pursuant to Section 60(B) of the National Internal Revenue Code. The latest affirmation was issued on August 11, 2009.

32. COMPLIANCE WITH REVENUE REGULATIONS (RR) NO.15-2010

In compliance with the requirements set forth by BIR RR No. 15-2010, hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year 2016.

32.1 Withholding Taxes

	2016	2015
Tax on compensation and benefits	**9,338,109**	9,264,743
Value-added taxes	**5,205,757**	5,028,655
Expanded withholding taxes	**6,616,221**	5,698,986
Percentage taxes	**102,165**	70,449
	21,262,252	20,062,833

32.2 Other Taxes

	2016	2015
Local		
Real estate taxes	**14,641,625**	14,696,224
Capital gains taxes	**11,471,218**	4,651,366
Transfer taxes/Others	**113,878**	132,767
National		
BIR annual registration	**500**	500
	26,227,221	19,480,857