**AFP RETIREMENT AND SEPARATION BENEFITS SYSTEM**

**NOTES TO FINANCIAL STATEMENTS**

 (All amounts in Philippine Peso unless otherwise stated)

# 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 Liquidators (BOL), 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, 2017, the System has 73 regular employees, 24 casual employees, 19 contractual personnel and 6 Project-hired or a total workforce of 122 personnel.

The financial statements of the System as of and for the year ended December 31, 2017 (including the comparative financial statements as of and for the year ended December 31, 2016) were authorized and approved for issue on March 22, 2018.

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.

# STATUS OF OPERATIONS

The System is engaged in various business operations to include the management of funds invested in the stock market, money market, treasury bills, 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 2017, sales of real estate properties declined from the previous years. The disposal of some of the assets 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 Board of Trustees (BOT) to act as 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.

On November 06, 2017, the GCG approved the divestment of the following equity shares and real estate properties of the System as an interim measure in order to expedite the liquidation process pending the System’s submission of its amended Winding down Plan:

Equity Shares:

* + - 1. Monterrosa Development Corporation (MDC)
			2. Southern Utility Management and Services, Inc. (SUMSI)

Real Estate Properties:

* + - 1. Lots 6B/6C/6D at Aseana City, Roxas Boulevard, Paranaque City
			2. Lot 6E at Aseana City, Roxas Boulevard, Paranaque City
			3. Lots 1979-I and 1981-A located at Sta. Rosa City, Laguna
			4. Calubcob property located at Silang City, Cavite
			5. Phase 2 of Green Meadows Iloilo Project

 All the Real Estate Projects, except for the Calubcob property were successfully bidded - out in 2018. The System’s Board of Liquidators approved the award of sale of the following properties on March 22, 2018 to the highest complying bidders:

|  |  |
| --- | --- |
| **Real Estate Assets for Auction** | **Award of Sale** |
| 1. | Green Meadows Iloilo  | P 1,251,000,000 |
| 2. | Lot 1979-I, Sta. Rosa, Laguna  | 23,641,200 |
| 3. | Lot 1981-A, Sta. Rosa, Laguna  | 10,500,000 |
| 4. | Lots 6B/6C/6D, Aseana City  | 3,316,509,038 |
| 5. | Lot 6E, Aseana City  | 1,794,344,509 |
| **Total** | **P 6,395,994,747** |

The foregoing assets are payable in cash within 30 days except for Green Meadows Iloilo which is payable in three years at an interest rate of four per cent per annum.

 For the Equity Shares, the bidding process for SUMSI has also started. The minimum bid price at which the shares of SUMSI are to be sold is pegged at P30 million.

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.

# 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.

# Basis of Preparation of Financial Statements

1. *Statement of Compliance with Philippine Financial Reporting Standards*

## The accompanying financial statements were prepared in compliance with 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.

1. *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).

1. *Basis of measurement*

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

1. *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.

1. *Functional and Currency 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.

# Adoption of New and Amended PFRSs

1. *Effective in 2017 that are Relevant to the System*

The System adopted for the first time the following amendment and annual improvement to PFRS, which is mandatorily effective for annual periods beginning on or after January 1, 2017:

 PAS 7 (Amendments): Statement of Cash Flows - Disclosure Initiative

Discussed below is the relevant information about this amendment and improvement:

1. PAS 7 (Amendments), *Statement of Cash Flows – Disclosure Initiative*. The amendments are designed to improve the quality of information provided to users of financial statements about changes in an entity’s debt and related cash flows (and non-cash changes). They require an entity to provide disclosures that enable users to evaluate changes in liabilities arising from financing activities. An entity applies its judgment when determining the exact form and content of the disclosures needed to satisfy this requirement. Moreover, they suggest a number of specific disclosures that may be necessary in order to satisfy the above requirement, including: (a) changes in liabilities arising from financing activities caused by changes in financing cash flows, foreign exchange rates or fair values, or obtaining or losing control of subsidiaries or other businesses; and (b) a reconciliation of the opening and closing balances of liabilities arising from financing activities in the statement of financial position including those changes identified immediately above.

The System has applied these amendments in the current year and has not disclosed comparative figures as allowed by the transitional provisions. A reconciliation between the opening and closing balances of liabilities arising from financing activities, which includes both cash and non-cash changes are presented in Note 31.

1. *Effective 2017 that are not relevant to the System*

 The following new PFRS amendments and annual improvements to existing standards are mandatorily effective for annual periods beginning on or after January 1, 2017 but are not relevant to the Company’s financial statements:

1. PAS 12 (Amendments), Income Taxes - Recognition of Deferred Tax Assets for Unrealized Losses. The focus of the amendment is to clarify how to account for deferred tax assets related to debt instruments measured at fair value, particularly where changes in the market interest rate decrease the fair value of a debt instrument below cost. The amendments provide guidance in the following areas where diversity in practice previously existed: (a) existence of a deductible temporary difference; (b) recovering an asset for more than its carrying amount; (c) probable future taxable profit against which deductible temporary differences are assessed for utilization; and, (d) combined versus separate assessment of deferred tax asset recognition for each deductible temporary difference. The application of this amendment has had no impact on the System’s financial statements.
2. PFRS 12 - Disclosure of Interest in Other Entities – Scope Clarification on Disclosure of Summarized Financial Information for Interests classified as held for sale.
3. PFRS 15, *Revenue from Contract with Customers* (effective from January 1, 2018)*.* This standard will replace PAS 18, *Revenue*, and PAS 11, *Construction Contracts*, the related Interpretations on revenue recognition: International Financial Reporting Interpretations Committee (IFRIC) 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreement for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers* and Standing Interpretations Committee 31, *Revenue – Barter Transactions Involving Advertising Services*. This new standard establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle in the said framework is for an entity to recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.
4. *Effective Subsequent to 2017 but not Adopted Early*

There are new PFRS and amendments to existing standards effective for annual periods subsequent to 2017, which are adopted by the FRSC. The System will adopt the following relevant pronouncements in accordance with their transitional provisions and, unless otherwise stated, none of these are expected to have significant impact on the System’s financial statements.

1. PAS 40 (Amendment), Investment Property – Reclassification to and from investment property (effective from January 1, 2018). The amendment states that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management’s intentions for the use of a property by itself does not constitute evidence of a change in use. The amendment provided a non-exhaustive list of examples constituting change in use. Management has assessed that this amendment has no significant impact on the Company’s financial statements.
2. PFRS 9 (2014), *Financial Instruments* (effective from January 1, 2018). This new standard on financial instruments will replace PAS 39, *Financial Instruments: Classification and Measurement,* and PFRS 9 (2009, 2010 and 2013 versions). This standard contains, among others, the following:
* three principal classification categories for financial assets based on the business model on how an entity is managing its financial instruments;
* an expected credit loss (ECL) model in determining impairment of all financial assets that are not measured at fair value through profit or loss (FVTPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset; and
* a new model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures.

 In accordance with the financial asset classification principle of PFRS 9 (2014), a financial asset is classified and measured at amortized cost if the asset is held within a business model whose objective is to hold financial assets in order to collect the contractual cash flows that represent solely payments of principal and interest (SPPI) on the principal outstanding. Moreover, a financial asset is classified and subsequently measured at fair value through other comprehensive income if it meets the SPPI criterion and is held in a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets. All other financial assets are measured at FVTPL.

 In addition, PFRS 9 (2014) allows entities to make an irrevocable election to present subsequent changes in the fair value of an equity instrument that is not held for trading in other comprehensive income.

 The accounting for embedded derivatives in host contracts that are financial assets is simplified by removing the requirement to consider whether or not they are closely related, and, in most arrangements, does not require separation from the host contract.

 For liabilities, the standard retains most of the PAS 39 requirements which include amortized cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The amendment also requires changes in the fair value of an entity’s own debt instruments caused by changes in its own credit quality to be recognized in other comprehensive income rather than in profit or loss.

1. PFRS 10 (Amendments), *Consolidated Financial Statements*, and PAS 28 (Amendments), *Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associates or Joint Venture* (effective date deferred indefinitely). The amendments to PFRS 10 require full recognition in the investor’s financial statements of gains or losses arising on the sale or contribution of assets that constitute a business as defined in PFRS 3, *Business Combinations*, between an investor and its associate or joint venture. Accordingly, the partial recognition of gains or losses (i.e., to the extent of the unrelated investor’s interests in an associate or joint venture) only applies to those sale of contribution of assets that do not constitute a business. Corresponding amendments have been made to PAS 28 to reflect these changes. In addition, PAS 28 has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.
2. IFRIC 22, *Foreign Currency Transactions and Advance Consideration - Interpretation on Foreign Currency Transactions and Advance Consideration* (effective from January 1, 2018). The interpretation provides more detailed guidance on how to account for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation states that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary asset (arising from advance payment) or liability (arising from advance receipt). If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Management has initially assessed that this amendment has no material impact on the Company’s financial statements.
3. Annual Improvements to PFRS 2014-2016 Cycle. Among the improvements, PAS 28 (Amendment), *Investment in Associates* – *Clarification on Fair Value through Profit or Loss Classification* (effective from January 1, 2018) is relevant to the Company. The amendments clarify that the option for venture capital organization, mutual funds and other similar entities to elect the fair value through profit or loss classification in measuring investments in associates and joint ventures shall be made at initial recognition, separately for each associate or joint venture.

 Management has initially assessed that this amendment has no material impact on the Company’s financial statements.

1. PAS 28 (Amendment), *Investment in Associates – Long-term Interest in Associates and Joint Venture* (effective from January 1, 2019). The amendment clarifies that the scope exclusion in PFRS 9 (2014) applies only to ownership interests accounted for using the equity method. Thus, the amendment further clarifies that long term interests in an associate or joint venture – to which the equity method is not applied – must be accounted for under PFRS 9 (2014), which shall also include long term interests that, in substance, form part of the entity’s net investment in an associate or joint venture. Management is currently assessing the impact of this new standard in its financial statements.
2. PFRS 9 (Amendment), *Financial Instruments – Prepayment Features with Negative Compensation* (effective from January 1, 2019). The amendment clarifies that prepayment features with negative compensation attached to financial instruments may still qualify under the SPPI test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at FVTOCI. Management is currently assessing the impact of this new standard in its financial statements.
3. PFRS 16, *Leases* (effective from January 1, 2019). The new standard will eventually replace PAS 17, *Leases*.

 For lessees, it requires to account for leases “on-balance sheet” by recognizing a “right of use” asset and a lease liability. The lease liability is initially measured as the present value of future lease payments. For this purpose, lease payments include fixed, non-cancellable payments for lease elements, amounts due under residual value guarantees, certain types of contingent payments and amounts due during optional periods to the extent that extension is reasonably certain. In subsequent periods, the “right-of-use” asset is accounted for similar to a purchased asset subject to depreciation or amortization. The lease liability is accounted for similar to a financial liability which is amortized using the effective interest method. However, the new standard provides important reliefs or exemptions for short-term leases and leases of low value assets. If these exemptions are used, the accounting is similar to operating lease accounting under PAS 17 where lease payments are recognized as expenses on a straight-line basis over the lease term or another systematic basis (if more representative of the pattern of the lessee’s benefit).

 For lessors, lease accounting is similar to PAS 17’s. In particular, the distinction between finance and operating leases is retained. The definitions of each type of lease, and the supporting indicators of a finance lease, are substantially the same as PAS 17’s. The basic accounting mechanics are also similar, but with some different or more explicit guidance in few areas. These include variable payments, sub-leases, lease modifications, the treatment of initial direct costs and lessor disclosures.

 Management is currently assessing the impact of this new standard in its financial statements.

1. IFRIC 23, *Uncertain over Income Tax Treatments* (effective from January 1, 2019). The interpretation provides clarification on the determination of taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates when there is uncertainty over income tax treatments. The core principle of the interpretation requires the Company to consider the probability of the tax treatment being accepted by the taxation authority. When it is probable that the tax treatment will be accepted, the determination of the taxable profit, tax bases, unused tax losses, unused tax credits, and tax rates shall be on the basis of the accepted tax treatment. Otherwise, the Company has to use the most likely amount or the expected value, depending on the surrounding circumstances, in determining the tax accounts identified immediately above. Management is currently assessing the impact of this new standard in its financial statements.
2. Annual Improvements to PFRS 2015-2017 Cycle. Among the improvements, the following amendments are relevant to the Company but had no material impact on the Company’s financial statements as these amendments merely clarify existing requirements:
* PAS 12 (Amendments), *Income taxes – Tax Consequences of Dividends*. The amendments clarify that all income tax consequence of dividend payments should be recognized in profit or loss.
* PAS 23 (Amendments), *Borrowing costs – Eligibility for Capitalization.* The amendments clarify that any specific borrowing which remains outstanding after the related qualifying asset is ready for its intended purpose, such borrowing will then form part of the entity’s general borrowings when calculating the capitalization rate for capitalization purposes.
* PFRS 3 (Amendments), *Business Combinations* and PFRS 11 (Amendments), *Joint Arrangements* – *Remeasurement of Previously Held Interests in a Joint Operation.*  The amendments clarify that previously held interest in a joint operation shall be remeasured when the Company obtains control of the business. On the other hand, previously held interests in a joint operation shall not be remeasured when the Company obtains joint control of the business.

# 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:

1. *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.

1. *Rental income*

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

1. *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.

1. *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.

1. *Dividend income*

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

# 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.

# Financial assets and liabilities

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

1. *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.

1. *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.

1. *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.

1. *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.

1. *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.

# Supplies and materials inventory

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

# 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 PFRS since majority of the audited financial statements of the System’s subsidiaries are not available because they are either closed or have ceased operations.

# 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.

# 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.

# 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.

# 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.

As per Standard Operating Procedure on Managing Foreclosed Accounts and Acquired Assets dated April 11, 2016, the System closes the loan account in the System’s books after consolidation and consequently records the foreclosed property as new acquired asset.

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.

# 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.

# 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.

# 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.

# 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.

# CASH AND CASH EQUIVALENTS

This account consists of the following:

|  | **2017** | 2016 |
| --- | --- | --- |
| Cash on hand  | **557,698** | 565,975 |
| Cash in banks | **38,198,782** | 59,226,374 |
| Cash equivalents | **3,000,000** | 529,000,000 |
|  | **41,756,480** | 588,792,349 |

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.

On November 22, 2017, the garnishment on the total deposit of P1.380 million of the System with a bank in its Camp Aguinaldo Branch was lifted pursuant to the Order issued by the Labor Arbiter of National Labor Relations Commission, Calamba City, Laguna. The subject account may now be utilized by the System.

For the year 2015, the System recognized a liability in the books amounting to P45.657 million 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 the System. 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. Thus, the balance of cash was reduced by P45.657 million as a result of garnishment in 2016.

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 System - that it 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 December 31, 2017, the case is still awaiting further resolution/disposition of the Honorable Court of Appeals with regard to the MR filed by the Developer.

# SHORT-TERM INVESTMENTS – NET

This account consists of marketable securities totaling to P901,390,519 and P755,041, 584 for CYs 2017 and 2016, respectively. Marketable securities include money market placements that earn interest at quoted rates ranging from 1.375 per cent to 1.65 per cent per annum, and various traded stock investments.

# RECEIVABLES – NET

This account consists of the following:

|  | **2017** | 2016(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)* | **19,634,664** | 16,242,192 |
| Accrued interest on loans and investments  | **55,159,467** | 57,187,386 |
| Non-trade receivables  | **16,154,550** | 16,154,550 |
| Receivable from employees/others | **5,172,073** | 5,228,487 |
| Advances to contractors  | **1,750,452** | 1,750,452 |
| Management fees *(See Note 28)* | **3,073,074** | 3,073,074 |
| Other receivables | **507,204,666** | 484,551,790 |
|  | **613,362,806** | 589,401,791 |
| Allowance for doubtful accounts | **(73,879,623)** | (73,879,623) |
|  | **539,483,183** | 515,522,168 |

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. As of 31 December 2017, the remaining receivable has a balance of P249.982 million or a decrease of P335,991 from the original amount.

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

# LOANS RECEIVABLE – NET

This account consists of the following:

|  | **2017** | 2016(As restated) |
| --- | --- | --- |
| Short-term loans  | **270,659,657** | 333,837,197 |
| Medium-term loans *(See Note 28)* | **61,918,478** | 49,624,818 |
| Past due loans | **126,520,837** | 127,006,747 |
| Accounts under litigation | **526,007,874** | 526,062,169 |
|  | **985,106,846** | 1,036,530,931 |
| Allowance for doubtful accounts | **(349,323,950)** | (349,823,950) |
| Unearned interest income | **(117,267,326)** | (117,267,326) |
|  | **518,515,570** | 569,439,655 |
| Current portion of short-term and medium-term loans | **(332,578,135)** | (383,462,015) |
|  | **185,937,435** | **185,977,640** |

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.

# OTHER CURRENT ASSETS

This account consists of the following:

|  |  |  |
| --- | --- | --- |
|  | **2017** | 2016(As restated) |
| Prepaid commissions | **17,377,977** | 17,711,048 |
| Prepaid tax | **13,663,507** | 11,736,769 |
| Prepaid subscriptions/membership | **1,689,680** | 368,360 |
| Prepaid supplies and materials  | **1,239,717** | 916,508 |
| Prepaid insurance | **420,271** | 485,876 |
| Prepaid repairs and maintenance | **213,167** | 295,847 |
|  | **34,604,319** | 31,514,408 |

Prepaid commissions pertain to the partial payments of commissions to brokers/ marketing agents relative to the sale of the System’s real estate inventories.

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

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

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.

# NON-CURRENT INVESTMENTS – NET

This account consists of marketable securities in the amount of P18,027,197 and P21,919,222 for CYs 2017 and 2016, respectively. Included in this category is the restricted Money Market Placement with a bank in the amount of P2.991 million which was used as collateral in the pending case with Department of Labor and Employment (DOLE). 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 resolution of the appeal before the DOLE.

The account also includes the Available For Sale financial assets in the total amount of P15.036 million which is inclusive of the cumulative unrealized gain on financial assets in the amount of P13.058 million. The cumulative unrealized gain is also presented in the SCI.

# INSTALLMENT CONTRACTS RECEIVABLE – NET

This account consists of the following:

|  |  |  |
| --- | --- | --- |
|  | **2017** | 2016(As restated) |
| ICR from sale of real estate inventory | 459,225,123 | 518,485,272 |
| ICR from sale of acquired assets | 4,143,600 | 4,148,591 |
| Past due ICR | 165,256,339 | 166,321,928 |
|  | 628,625,062 | 688,955,791 |
| Allowance for doubtful accounts | (165,323,009) | (165,323,009) |
|  | **463,302,053** | **523,632,782** |

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.

# ADVANCES TO SUBSIDIARIES AND ASSOCIATES – NET

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

|  | **2017** | 2016 |
| --- | --- | --- |
| Bay Resources Development Corporation  | **13,191,805** | 13,191,805 |
| Monterrosa Development Corporation  | **12,406,245** | 12,136,245 |
| Matrix Realty and Development Corporation  | **5,894,093** | 5,894,093 |
| Veterans Electronics Communications, Inc.  | **1,768,761** | 1,768,761 |
| Public Securities Corporation | **1,420,991** | 1,420,991 |
| Others | **659,520** | 659,520 |
|  | **35,341,415** | 35,071,415 |
| Allowance for doubtful accounts | **(17,837,110)** | (17,837,110) |
|  | **17,504,305** | 17,234,305 |

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 the System representing interest amounting to P10.211 million 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.

# 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** | **2017** | 2016(As restated) |
| --- | --- | --- | --- |
| **Acquisition cost** |  |  |  |
| Monterrosa Development Corporation (MDC) | 100.00 | **873,927,445** | 873,927,445 |
| Marilaque Land, Inc. (MLI) | 40.00 | **609,000,000** | 609,000,000 |
| Bay Resources Development Corporation (BRDC) | 50.00 | **402,000,000** | 402,000,000 |
| Philippine Airlines (PAL) | 00.31 | **500,000,000** | 500,000,000 |
| Amtrust Holdings, Inc.  | 10.92 | **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 | **126,738,598** | 126,738,598 |
| 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 |  | **(528,555,100)** | (530,303,822) |
| Adjustment of prior year share in Net Earnings |  | **-** | (503,397) |
| Equity in net earnings (losses) for the year |  | **4,909,295** | 2,252,119 |
| Accumulated equity in net losses, ending |  |  **(523,645,805)** | (528,555,100) |
| Cumulative liquidating dividends – SUMSI |  | **(18,000,000)** | (11,500,000) |
| Liquidating Dividend – RICH |  | **(3,151,447)** | - |
| Deferred income |  | **(196,508,125)** | (196,508,125) |
| Allowance for decline in value |  | **(946,616,466)** | (946,616,466) |
|  |  |  **(1,687,921,843)** | (1,683,179,691) |
|  |  | **1,375,458,407** | 1,380,200,559 |

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 P16.590 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 P19.879 million 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 million as of the end of 2014 and up to this date.

In 2017, GCG approved the divestment of Monterrosa Development Corporation and Southern Utility Management Services, Inc. (SUMSI). The Bidding Process for SUMSI has also started. The minimum Bid Price at which the shares of SUMSI are to be sold is pegged at P30 million. Further, the System’s shares in PAL and BRADCO were also approved for disposal by the AFPRSBS BOL on March 22, 2018.

# INVESTMENTS IN REAL ESTATE - NET

This account consists of the following:

|  |  |  |
| --- | --- | --- |
|  | **2017** | 2016 |
| Landbanking assets  | **3,294,836,290** | 3,286,794,884 |
| Commercial and residential subdivision projects  | **3,020,437,395** | 3,060,350,209 |
| Member-related housing projects | **74,238,404** | 74,238,404 |
| Golf and country club shares | **132,782,138** | 133,318,138 |
|  | **6,522,294,227** | 6,554,701,635 |
| Allowance for decline in value of investment in real estate |  **(115,062,687)** |  (112,362,251) |
|  | **6,407,231,540** | 6,442,339,384 |

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 housing 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 2017, there are still possible remaining deliverables of the System to the Riviera Golf Club, Inc. and Riviera Sports and Country Club, Inc.

# INVESTMENT PROPERTY – NET

This account consists of the following:

|  | **2017** | 2016 |
| --- | --- | --- |
| 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 | **5,600,000** | 5,856,000 |
|  | **20,398,979** | 20,654,979 |

In 2014, the System executed a contract with HMRID Property Inc. for the lease of a 40,000 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 per square meter or a total of P32 million. The System incurred a direct cost of P6.400 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 2017, the System recorded the contingent rent amounting to P13.132 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, 2017:

|  | **HMRID** | **PSMT** | **Total** |
| --- | --- | --- | --- |
| 2018 | 41,088,000 | 3,057,784 | 44,145,784 |
| 2019 | 43,724,480 | 3,057,784 | 46,782,264 |
| 2020 | 43,964,160 | 3,057,784 | 47,021,944 |
| 2021 | 46,785,194 | 3,057,784 | 49,842,978 |
| 2022 | 47,041,651 | 3,057,784 | 50,099,435 |
| Later years |  1,123,208,721 | 3,057,783 | 1,126,266,504 |
|  | **1,345,812,206** | **18,346,703** | **1,364,158,909** |

The System used the year-end exchange rate of P49.923 in estimating the minimum future rental payments for PSMT.

Future rentals for PSMT starting second quarter of 2018 will not be realized anymore since the property was disposed in April 2018.

# PROPERTY AND EQUIPMENT - NET

This account consists of the following:

|  | **Building Improvements** | **Office Equipment** | **Transportation Equipment** | **Furniture****and Fixtures** | **Total** |
| --- | --- | --- | --- | --- | --- |
| **Cost** |  |  |  |  |  |
| Balance, 1/1/2017 | 91,429,579 | 149,217,182 | 8,283,853 | 15,714,472 | 264,645,086 |
| Additions (Deductions) | - | 49,909 | - | 159,294 | 209,203 |
| Balance, 12/31/2017 | 91,429,579 | 149,267,091 | 8,283,853 | 15,873,766 | 264,854,289 |
| **Accumulated depreciation** **and amortization** |  |  |  |  |  |
| Balance, 1/1/2017 | 82,286,621 | 128,724,500 | 7,413,036 | 12,344,996 | 230,769,153 |
| Depreciation/amortization |  -  | 1,196,654 | - | 201,962 | 1,398,616 |
| Balance, 12/31/2017 | 82,286,621 | 129,921,154 | 7,413,036 | 12,546,958 | 232,167,769 |
| **Net book value, 12/31/2017** | **9,142,958** | **19,345,937** | **870,817** | **3,326,808** | **32,686,520** |
| **Net book value, 12/31/2016** | **9,142,958** | **20,492,682** | **870,817** | **3,369,476** | **33,875,933** |

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 million.The System, however, is using cost method in the recording of its properties and equipment.

# INVESTMENT IN BONDS

This account consists of the following:

|  |  |  |
| --- | --- | --- |
|  | **2017** | 2016 |
|  |  |  |
| Treasury bonds | **4,452,403,407** | 4,367,629,158 |
| 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 |
|  | **5,352,403,407** | 5,267,629,158 |

The investments earn an average yield of 3.354 per cent interest per annum with terms ranging from two to ten 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.

# OTHER NON-CURRENT ASSETS – NET

This account consists of the following:

|  | **2017** | 2016(As restated) |
| --- | --- | --- |
| Acquired assets *(See Note 3.11)* | **494,842,883** | 497,287,205 |
| Allowance for probable losses | **(38,960,432)** | (38,960,432) |
|  | **455,882,451** | 458,326,773 |
| Deposits and others | **7,740,633** | 8,901,380 |
|  | **463,623,084** | 467,228,153 |

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. On 04 April 2017, AFPRSBS sent a letter to the Insurance Commission requesting for the release of mortgage covering the condominium units located at Ciana Plaza Condominium and the immediate release of Owner’s Duplicate Copy of CCT Nos. 51527,51528,51528,51530, and 51534. As of 31 December 2017, however, the System is still awaiting reply from the Insurance Commission.

# ACCOUNTS PAYABLE AND ACCRUED EXPENSES

These accounts consist of the following:

|  | **2017** | 2016(As restated) |
| --- | --- | --- |
| Trade payables | **143,995,288** | 143,574,514 |
| Non-trade payables | **193,639,559** | 174,035,429 |
| Reserve for real estate development | **35,186,631** | 35,841,350 |
| Accrued employee benefits | **96,779,295** | 78,237,531 |
| Accrued operating expenses | **27,916,961** | 28,639,023 |
| Retention payable | **21,430,096** | 21,964,910 |
| Payable to real estate brokers | **20,901,949** | 18,242,245 |
| Payable to landowners | **6,851,650** | 6,851,650 |
| Buyer’s refund payable | **1,899,289** | 1,266,122 |
| Other payables | **7,025,887** | 10,420,031 |
|  | **555,626,605** | 519,072,805 |

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.

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 2017, a total of P7.822 million were paid to contractors representing either partial or full payment for the completion of various projects that were undertaken at Riviera, Villa Segovia, Mount Zion, 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 P37.191 million, of which, P13.389 million pertains to accruals for 2017. The amount is net of the P3.786 million separation costs that were paid to 10 separated employees in 2016 and 2017.

# 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.

# 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.

# ESTIMATED LIABILITY ON EARNINGS OF MEMBERS’ CONTRIBUTIONS

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

|  | **2017** | 2016 |
| --- | --- | --- |
| Balance at beginning of year | **3,763,101,671** | 3,925,080,979 |
| Payments/adjustments made | **(274,815,002)** | (161,979,308) |
| Balance at end of year | **3,488,286,669** | 3,763,101,671 |
| Current portion |  **(202,567,785)** |  (256,148,623) |
|  | **3,285,718,884** | 3,506,953,048 |

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.

# 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 Supreme Court (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, 2017, the remaining Fund Equity of the System is composed of the P200 million government contributions, retained earnings of P1.394 billion and other comprehensive income of P2.326 million representing the cumulative income on changes in fair value of stocks. The System’s Retained Earnings account continued to increase since the stoppage of the accrual of interest on members contributions effective March 2016.

# 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).*

# REVENUES

Revenues consist of the following:

|  |  **2017** |  **2016** |
| --- | --- | --- |
| **Fund management operations** |  |  |
|  Income from Long-term investments | 174,712,878 | 154,373,411 |
|  Interest on MMP/deposit in banks/treasury bills | 18,291,639 | 40,185,859 |
|  Income from stocks/Dividends | 1,087,884 | 663,685 |
|  | 194,092,401 | 195,222,955 |
|  |  |  |
| **Lending operations** |  |  |
|  Interest on ICRs | 21,766,313 | 26,629,348 |
|  Interest on advance refunds | 15,949,355 | 14,163,178 |
|  Interest on commercial loans | 2,573,840 | 2,437,437 |
|  Interest on employee loans | 682,170 | 756,414 |
|  Interest on discounting of commutation of leave | 66,775 | 339,667 |
|  Interest on multi-purpose loans | 20,436 | 150,800 |
|  Other income | 4,981,196 | 7,462,562 |
|  | 46,040,085 | 51,939,406 |
|  |  |  |
| **Real estate rentals** |  |  |
|  Rentals from IPMO – net | 102,442,324 | 110,657,205 |
|  Rentals from real estate properties - net | 24,591,314 | 15,115,582 |
|  | 127,033,638 | 125,772,787 |
|  |  |  |
| **Real estate operations** |  |  |
|  Sale of real estate inventories - net | 133,998,429 | 187,732,098 |
|  Income from acquired assets - net | 8,843,830 | 7,876,023 |
|  Other income | 6,723,842 | 9,090,199 |
|  | 149,566,101 | 204,698,320 |
|  |  |  |
| **Equity holdings in subsidiaries and associates** | 4,909,295 | 2,252,119 |
|  | **521,641,520** | **579,885,587** |

# DEPRECIATION AND AMORTIZATION

This account consists of the following:

|  | **2017** | 2016 |
| --- | --- | --- |
| Property and equipment | **1,444,383** | 2,358,079 |
| Investments in real estate | **2,700,437** | 2,700,437 |
|  | **4,144,820** | 5,058,516 |

# 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.

# EMPLOYEE BENEFITS

Included in the accrued employee benefits are the accruals made for the provision for employee separation benefits in the total amount of P37.191 million, of which, P13.389 million pertains to accruals for 2017. The amount is net of the P3.786 million separation costs that were paid to ten separated employees in 2016 and 2017.

# 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:

|  | **2017** | 2016 |
| --- | --- | --- |
| Receivables *(See Note 6)* | **3,073,074** | 3,073,074 |
| Receivable from joint venture partner *(See Note 6)* | **19,634,664** | 16,242,192 |
| Loans receivable *(See Note 7)* | **49,624,818** | 49,624,818 |
| Advances to subsidiaries and associates *(See Note 11)* | **35,341,415** | 35,071,415 |
| Accounts payable and accrued expenses | **99,142,024** | 80,006,961 |
|  | **206,815,994** | 184,018,460 |

# 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.

# RETAINED EARNINGS

|  | **2017** | 2016(As restated) |
| --- | --- | --- |
| Balance, January 1 | 987,483,703 | 646,554,360 |
| Correction of prior period errors\* | - | 122,480,235 |
| Profit for the year | 406,995,016 | 218,449,108 |
|  | **1,394,478,719** | **987,483,703** |

In consonance with IAS No. 8 (Accounting Policies, Changes in Accounting Estimates and Errors), the Retained Earnings for CY 2016 was restated as follows:

|  |  |
| --- | --- |
|  | **2016** |
| Balance at beginning of year as previously reported | 997,231,502 |

|  |  |  |
| --- | --- | --- |
| Correction/adjustment of prior years’ errors\* |  | 16,623,070 |
| Loss for CY 2015 as reported |  | (367,300,212) |
| **Restated balance at January 1, 2016** | **646,554,360** |

\*Correction/adjustment of prior years’ errors consists of various income from lending and real estate operations and other expenses amounting to P16.623 million and P122.480 million.

The profit for CY 2016 was restated as follows:

|  |  |  |
| --- | --- | --- |
|  |  |  **2016** |
| Balance at the beginning of the year as |  |  |
|  previously reported |  | 221,002,766 |
| Correction/adjustment of prior year errors: |  |  |
| Decrease in revenues | (1,554,876) |  |
| Investment and operating expenses | 421,207 |  |
| General and administrative expenses | 577,575 | (2,553,658) |
| **Profit for CY 2016, as restated** |  | **218,449,108** |

# RECONCILIATION OF LIABILITIES ARISING FROM FINANCING ACTIVITIES

|  |  |
| --- | --- |
| **Liabilities to the Members** |  **2017** |
| Balance, January 01, 2017 | 14,649,550,687 |
| Cash flows from Financing Activities |  |
|  Additional Contributions | 80,133 |
|  Payment of Contributions | (572,259,203) |
| Non-cash Financing Activities |  |
| Adjustment of matured loans/Others | (345,239,826) |
| Balance, December 31, 2017 | **13,732,131,791** |

# 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.

# 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 2017.

* 1. **Withholding Taxes**

|  |  |  |
| --- | --- | --- |
|  |  **2017** |  2016 |
| Tax on compensation and benefits | **9,761,816** | 9,338,109 |
| Expanded withholding taxes | **4,943,011** | 6,616,221 |
| Final withholding on value-added taxes | **3,262,964** | 5,205,757 |
| Percentage taxes  | **67,378** | 102,165 |
|  | **18,035,169** | 21,262,252 |

* 1. **Other Taxes**

|  |  |  |
| --- | --- | --- |
|  |  **2017** |  2016 |
| **Local** |  |  |
| Real estate taxes | **14,563,283** | 14,641,625 |
| Capital gains taxes | **12,659,922** | 11,471,218 |
| Transfer taxes/Others  | **417,510** | 113,878 |
|  |  |  |
| **National** |  |  |
| BIR annual registration | **500** | 500 |
|  | **27,641,215** | 26,227,221 |