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 (P.D.) 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 P.D. No. 361 pertaining to membership and rate of contributions were amended by P.D. No. 1656 dated December 21, 1979 and P.D. No. 1909 dated March 22, 1984.

The System was not able to discharge its mandate originally set out in P.D. No. 361 because it has not paid a single peso for retirement benefits of the retiring AFP personnel. All payments of retirement benefits to AFP military personnel, before and after the promulgation of its Charter, have been made from the regular annual appropriation of AFP as set out in the General Appropriation Act (GAA). Thus, Executive Order (E.O.) Nos. 590 and 590A were issued in December 15, 2006 and January 31, 2007, respectively, mandating the deactivation of the AFPRSBS and directing the transfer of its assets in trust to a government financial institution (GFI).

The Board of Liquidators (BOL), originally consisting of 11 active or retired members but currently having nine members and two seats vacancy due to resignation, is the policy making body of the System. Each was appointed by the AFP Chief of Staff who also appointed the President/Chief Executive Officer (CEO) of the System. The President/CEO as well as the Executive Vice President/Chief Operating Officer takes charge of the day to day affairs of the organization. In a letter request for the Department of National Defense (DND) dated March 31, 2019, the System requested for authority not to fill up the position vacated by the representative from the retired AFP Officers and AFP Enlisted Personnel but still pending approval. As of December 31, 2018, the System has 73 regular employees, 37 casual employees, six contractual personnel and four project-hired employees or a total workforce of 120 personnel.

The financial statements of the System as at and for the year ended December 31, 2018 (including the comparative financial statements as at and for the year ended December 31, 2017) were authorized and approved for issue by the BOL as per Minutes of BOL Meeting No. 01-2019.

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, treasury bills, government 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 of 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 year 2018 is a banner year for the System due to the sale of its seven major real estate assets. 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 (M.O.) 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 M.O. 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; 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 (NEDA) 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 M.O. No. 90, the GCG shall be assisted by a Technical Working Group (TWG) composed of representatives from the DND, Department of Finance (DOF), Department of Budget and Management (DBM), Privatization Management Office (PMO), the System, and the AFP.

On April 19, 2016, pursuant to the above M.O., 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 (B.R.) No. SPL-01-2016. In the same meeting, the BOL also approved the continuance of the implementation of the Advance Refund Program to retiring military personnel with approved Order of Retirement from the AFP until the final closure of the System.

In 2018, seven real estate properties were successfully bidded-out. The AFPRSBS BOL approved the award of sale of Green Meadows Iloilo; Lot 1979-I, Sta. Rosa, Laguna; Lot 1981-A, Sta. Rosa, Laguna; Lots 6B/6C/6D, Aseana City and Lot 6E, Aseana City on March 22, 2018 to the highest complying bidders with a total selling price of P6.396 billion.

The proceeds from the sale of the properties, except for Green Meadows Iloilo Phase 2 Project, were received in cash by the System in April 2018. The same were re-invested in money market placements (MMP) and treasury bills that contributed to the tremendous increase in interest earnings of the System.

For the Green Meadows Iloilo Phase 2 Project, which is payable at 20 per cent downpayment and the balance payable in three years at an interest rate of four per cent per annum, the System received an amount of P250.200 million in April 2018 representing the downpayment. A total amortization payment of P266.760 million or P88.920 million per quarter in 2018 was paid to the System.

For the equity shares, the bidding process for Southern Utility Management and Services, Inc. (SUMSI) held on April 18, 2018 was suspended due to the protest filed by the losing bidder. To date, the System is still awaiting for the opinion from the Office of the Government Corporate Counsel (OGCC) on the merits of the protest filed by the losing bidder.

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 adjustment 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 and eventual refund of all members' contributions.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3.1. Basis of Preparation of Financial Statements

a. Statement of Compliance with Philippine Financial Reporting Standards

The accompanying financial statements have been 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 (FRSC) and approved by the Philippine Board of Accountancy (BOA) based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

b. Presentation of financial statements

The financial statements are presented in accordance with 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. Functional and presentation currency

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 2018 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, 2018:

- PFRS 9 (2014), *Financial Instruments* (effective from January 1, 2018). This new standard on financial instruments will replace PAS 39, *Financial Instruments: Recognition and Measurement, and PFRS 9 (2009, 2010 and 2013 versions*). It provides requirements for the classification and measurement of financial assets and liabilities, impairment, hedge accounting, recognition, and derecognition.

- PFRS 9 requires all recognized financial assets to be subsequently measured at amortized cost or fair value (through profit or loss or other comprehensive income), depending on their classification by reference to the business model within which these are held and its contractual cash flow characteristics.

- For financial liabilities, the most significant effect of PFRS 9 relates to cases where the fair value option is taken: the amount of change in fair value of financial liability designated as at fair value through profit or loss (FVPL) that is attributable to changes in the credit risk of that liability is recognized in other comprehensive income (rather than in profit or loss), unless this creates an accounting mismatch.

- For the impairment of financial assets, PFRS 9 introduces "expected credit loss" (ECL) model based on the concept of providing for the ECL at inception of a contract; recognition of a credit should no longer wait for there to be objective evidence of impairment.

- The derecognition provisions are carried over almost unchanged from PAS 39.

Based on the System's analysis of its business model and the contractual cash flow characteristics of its financial assets and liabilities as of December 31, 2018, the System concluded that all of its financial assets and liabilities shall be classified under the new classification categories of PFRS 9.

The following table shows the original classification categories under PAS 39 and the new classification categories under PFRS 9 for each class of the System's financial assets as of January 1, 2018 (in thousands):

	PAS 39 measurement category				PFRS 9 measurement category	
	Cash and cash equivalents	Available for sale	Held to maturity	Loans and receivables	FVOCI*	Amortized cost
Cash and cash equivalents	P 41,756	P -	P -	P -	P -	P 41,756
Stock investment		15,036	-	-	15,036	-
Investment in bonds		-	5,352,403	-	-	5,352,403
Short-term investments		-	904,382	-	-	904,382
Loans and receivables		-	-	725,421	-	725,421

**Financial assets at fair value through other comprehensive income*

The System assessed that the adoption of PFRS 9, specifically in determining the expected credit loss using the simplified approach, has no significant impact on the carrying amounts of the financial assets carried at amortized cost.

- PFRS 15, *Revenue from Contracts with Customers* – The new standard replaces PAS 11, *Construction Contracts,* PAS 18, *Revenue,* and their related interpretations. It establishes a single comprehensive

framework for revenue recognition to apply consistently across transactions, industries and capital markets, with a core principle (based on a five-step model to be applied to all contracts with customers), enhanced disclosures, and new and improved guidance (e.g. the point at which revenue is recognized, accounting for variable considerations, cost of fulfilling and obtaining a contract, etc.).

Based on the System's assessment, all of the contracts with customers are generally undertaken to provide single performance obligation at a fixed price which is mainly the rendering of services. Thus, the allocation of transaction price to the single performance obligation is not applicable. The System recognizes the revenue as the services rendered over time. Accordingly, the adoption of PFRS 15 has no significant impact in the timing of the System's revenue recognition.

- PFRS 15 (Amendment), *Revenue from Contracts with Customers – Clarification to PFRS 15* – The amendments provide clarifications on the following topics: (a) identifying performance obligations; (b) principal versus agent considerations; and (c) licensing. The amendments also provide some transition relief for modified contracts and completed contracts.

b. <u>Effective in 2018 that are Not Relevant to the System</u>

- 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 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 System's financial statements.

- PFRS 2 (Amendments), *Share-based Payments – Clarifying How to Account for Certain Types of Share-based Payment Transactions* (effective from January 1, 2018). This amendment clarifies the measurement basis for cash-settled, share-based payments and the accounting for modifications that change an award from cash-settled to equity-settled. It also introduces an exception to the principles in PFRS 2 that will require an award to be treated as if it was wholly equity-settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share-based payment and pay that amount to the tax authority.

- PFRS 4 (Amendments), *Insurance Contracts – Applying PFRS 9, Financial Instruments with PFRS 4, Insurance Contracts*. The amendments give all insurers the option to recognize in other

comprehensive income, rather than profit or loss, the volatility that could arise when PFRS 9, *Financial Instruments* is applied before implementing PFRS 17, *Insurance Contracts* ('the overlay approach'). Also, entities whose activities are predominantly connected with insurance are given an optional temporary exemption (until 2021) from applying PFRS 9. Thus, continuing to apply PAS 39, *Financial Instruments: Recognition and Measurement* instead ('the deferral approach').

- 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 System's financial statements.

- 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 not relevant to the System. The amendments clarify that the option for venture capital organization, mutual funds and other similar entities to elect the FVPL 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 System's financial statements.

c. <u>New and Amended PFRSs Issued But Not Yet Effective</u>

Relevant new and amended PFRSs which are not yet effective for the year ended December 31, 2018 and have not been applied in preparing the financial statements are summarized below.

Effective for annual periods beginning from January 1, 2019:

- PAS 28 (Amendment), *Investment in Associates – Long-term Interest in Associates and Joint Venture*. 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.

- PFRS 9 (Amendment), *Financial Instruments – Prepayment Features with Negative Compensation*. The amendment clarifies that prepayment features with negative compensation attached to financial instruments may still qualify under the Solely Payments of Principal and Interest (SPPI) test. As such, the financial assets containing prepayment features with negative compensation may still be classified at amortized cost or at FVOCI. Management is currently assessing the impact of this new standard in its financial statements.

- PFRS 16, *Leases*. 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. 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.

- IFRIC 23, *Uncertain over Income Tax Treatments*. 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 System 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 System 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.

Annual Improvements to PFRS 2015-2017 Cycle. Among the improvements, the following amendments are relevant to the System but have no material impact on the System'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 System obtains control of the business. On the other hand, previously held interests in a joint operation shall not be remeasured when the System obtains joint control of the business.

Effective for annual periods beginning on or after January 1, 2020 and thereafter:

- PAS 1 (Amendments), *Presentation of Financial Statements* and PAS 8 (Amendments), *Accounting Policies, Changes in Accounting Estimates and Errors.* Clarifies the definition of 'material' and to align the definition used in the Conceptual Framework and the standards themselves. It provides that Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

- PAS 19 (Amendments), *Employee Benefits.* The amendments in Plan Amendment, Curtailment or Settlement are: if a plan amendment,

curtailment or settlement occurs, it is now mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement; and in addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling.

- PFRS 3 (Amendments), *Business Combination*. The amendments narrowed the definition of a business and of outputs by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs. It clarifies that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. It also adds an optional concentration test that permits a simplified assessment of whether an acquired set of activities and assets is not a business.

- PFRS 17, *Insurance Contracts.* This standard will replace PFRS 4, *Insurance Contracts*. It requires insurance liabilities to be measured at current fulfillment value and provides a more uniform measurement and presentation approach to achieve consistent, principle-based accounting for all insurance contracts. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued.

Deferred effectivity

- Amendments to PFRS 10, *Consolidated Financial Statements* and PAS 28, *Investments in Associates and Joint Ventures – Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture.* The amendments address a current conflict between the two standards and clarify that a gain or loss should be recognized fully when the transaction involves a business, and partially if it involves assets that do not constitute a business. The effective date of the amendments, initially set for annual periods beginning on or after January 1, 2016, was deferred indefinitely in December 2015 but earlier application is still permitted.

Under prevailing circumstances, the adoption of the foregoing new and amended PFRSs is not expected to have any material effect on the financial statements of the System.

3.3. Revenue recognition

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 (HDMF), 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.

f. Share from income of equity holdings

Revenue is recognized equal to the System's percentage of ownership from its subsidiaries and controlled entities' declared net income for a specific period.

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 from the date of acquisition and that are subject to an insignificant risk of change in value.

3.5. Financial assets

a. Financial Assets at FVOCI

These financial assets are carried at fair values and are presented in the non-current assets section of the System's Statements of Financial Position. Changes in the fair value of such assets are recognized in other comprehensive income and presented within reserves in the unrealized gain or loss on FVOCI financial assets portion. When an equity instrument classified at FVOCI is derecognized, the cumulative gains or losses cannot be transferred/recycled to profit or loss anymore. While when debt instrument classified at FVOCI is derecognized, the gain or loss is transferred to profit or loss. For the remaining stock investments of AFPRSBS, the System elected to measure these financial assets at FVOCI.

b. Financial Assets at Amortized Cost

These instruments are financial assets with fixed or determinable payments and fixed maturities. It meets both of the following conditions and is not designated as at FVPL:

- It is held within a business model whose objective is to hold financial assets to collect contractual cash flows; and

- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The System's cash and cash equivalents, short-term investments (MMP and treasury bills) and long-term bonds are included under this category.

c. Loans and receivables

Loans and receivables are stated at the outstanding balance reduced by an allowance for expected credit losses. 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 expected credit losses is measured by Management in accordance with the provisions of PFRS 9.

d. Impairment of financial assets

AFPRSBS assesses at each statement of financial position date whether there is objective evidence that a financial asset or group of financial assets is impaired. The System adopts the ECL model in measuring credit impairment in accordance with PFRS 9. In this respect, it shall recognize credit impairment/allowance for credit losses even before an objective evidence of impairment becomes apparent. The amount of the loss shall be recognized in profit or loss.

e. Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; and

- the System has transferred its rights to receive cash flows from the asset and either: (a) has transferred substantially all the risks and rewards of the asset; or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the System has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the System's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred financial asset is measured at the lower of the original carrying amount of the financial asset or the maximum amount of consideration that the System could be required to repay.

In the event that the transaction qualifies for the derecognition of equity instruments classified as FVOCI by the System, the difference between the consideration received and the carrying amount of financial assets is recognized as realized gain/loss and reported in the profit or loss statement while the cumulative unrealized gain/loss reported in other comprehensive account remains within the equity.

3.6. Real estate inventories

Inventories are carried at cost. The average cost method is used in calculating the actual cost per square meter of the inventories which is calculated by dividing the actual total cost by the total number of sellable area for each project.

3.7. Supplies and materials inventory

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

3.8. Investments in subsidiaries

Investments in subsidiaries and associates are accounted for at carrying amounts equivalent to the percentage of the entities' net assets or equity since the System prepares separate financial statements from its subsidiaries and associates. 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.

The System recognizes in its statements of comprehensive income, its equity share in the net earnings or losses of subsidiaries and associates since dates of acquisition. Dividends received are recognized in profit or loss in the separate financial statements of the System when the right to receive the dividend is established.

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

3.9. Investments in real estate

Investments in real estate are carried at cost. These consist of raw land properties which are not available for sale.

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.

3.10. 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.

3.11. 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 expense 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 (COA) 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.

3.12. 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 the 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 AFPRSBS books after consolidation and consequently records the foreclosed property as newly 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.

3.13. 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 statements of financial position date and the amount can be reasonably estimated. Otherwise, the loss contingency was disclosed only.

3.14. 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.

3.15. 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.

3.16. 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:

	2018	2017
Cash on hand	**645,959**	557,698
Cash in banks	**31,404,613**	38,198,782
Cash equivalents	**130,000,000**	3,000,000
	162,050,572	41,756,480

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

On November 22, 2017, the garnishment on the total deposit of P1,379,705 of the System with Landbank of the Philippines (LBP) - Camp Aguinaldo Branch was lifted pursuant to the Order issued by the Labor Arbiter of National Labor Relations Commission, Calamba City, Laguna. As of December 31, 2018, subject account is now being used by the System.

In 2015, the System recorded a Provision for Garnishment Loss amounting to P45,656,843 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. A corresponding liability was set-up for the same amount. The provision was approved by the BOT in its February 15, 2016 meeting. 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 Regional Trial Court (RTC) Branch 93.

On January 22, 2016, the Branch Manager of the private bank issued a Manager's Check with the same amount in favor of the complainant Developer. The bank account amounting to P45,656,843 was closed after the release of the fund by private bank.

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 December 31, 2018, the case is still awaiting further resolution/disposition of the Honorable CA with regard to the MR filed by adverse party.

5. SHORT-TERM INVESTMENTS

This account consists of the following:

	2018	2017
Government securities	**4,280,787,493**	-
Marketable securities	**1,811,958,600**	901,390,519
	6,092,746,093	901,390,519

Short-term investments include MMP and treasury bills that earn interest at quoted rates ranging from 1.375 per cent to 6.5 per cent per annum.

6. RECEIVABLES – NET

This account consists of the following:

	2018	2017
Receivable from sale of real estate properties in JV projects	**5,213,860**	5,213,860
Receivable from JV partner *(Note 29)*	**20,127,108**	19,634,664
Accrued interest on loans and investments	**69,681,920**	55,159,467
Non-trade receivables	**16,154,550**	16,154,550
Receivable from employees/others	**5,205,009**	5,172,073
Advances to contractors	**1,750,452**	1,750,452
Management fees *(Note 29)*	**2,673,074**	3,073,074
Other receivables	**525,987,957**	507,204,666
	646,793,930	613,362,806
Allowance for doubtful accounts	**(73,879,623)**	(73,879,623)
	572,914,307	539,483,183

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.

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 G.R. No. 217948 dated January 12, 2016. Accordingly, a Notice of Finality of Decision and COA Order of Execution were issued. As of December 31, 2018, the remaining receivable has a balance of P249.142 million or a decrease of P1.176 million 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.

7. LOANS RECEIVABLE – NET

This account consists of the following:

	2018	2017
Short-term loans	**71,561,750**	270,659,657
Medium-term loans *(Note 29)*	**80,527,822**	61,918,478
Past due loans	**374,820,444**	375,127,491
Accounts under litigation	**526,629,004**	526,007,874
	1,053,539,020	1,233,713,500
Allowance for doubtful accounts	**(349,323,950)**	(349,323,950)
Unearned interest income	**(117,267,326)**	(117,267,326)
	586,947,744	767,122,224
Current portion of short-term and medium-term loans	**(152,089,572)**	(332,578,135)
	434,858,172	434,544,089

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 M.O. No. 90 on April 8, 2016, the System stopped the granting of all loans to members except the advance refunds. In November 2018, however, the BOL approved the recommendation of Management to stop the Advance Refund Program effective December 28, 2018 due to the implementation of the Accelerated Refund Program starting January 2019.

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. REAL ESTATE INVENTORIES - NET

This account consists of the following:

	2018	2017
Club share inventories	**1,004,632,596**	1,003,110,972
Other inventories	**2,946,941,976**	3,182,332,407
	3,951,574,572	4,188,443,379
Allowance for decline in value of inventories	**(76,203,580)**	(73,503,143)
	3,875,370,992	4,114,940,236

This account consists of real estate inventories held for sale in the ordinary course of business.

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 recognized 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 31, 2018, there are still possible remaining deliverables of the System to the Riviera Golf Club, Inc. and Riviera Sports and Country Club, Inc.

9. OTHER CURRENT ASSETS

This account consists of the following:

	2018	2017
Prepaid tax	**14,273,642**	13,663,507
Prepaid commissions	**13,234,630**	17,377,977
Prepaid supplies and materials	**1,216,052**	1,239,717
Prepaid insurance	**473,227**	420,271
Prepaid subscriptions/membership	**368,360**	1,689,680
Prepaid rental	**101,400**	-
Prepaid repairs and maintenance	**95,354**	213,167
	29,762,665	34,604,319

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

The prepaid rental pertains to the System's security deposit for the office space being leased by the System in Iloilo City.

Prepaid repairs and maintenance pertains to the remaining unamortized cost for maintenance and support service for the AFPRSBS' existing servers, particularly, three IBM System X3500 and one HP Net Server LC3.

10. INSTALLMENT CONTRACTS RECEIVABLE – NET

This account consists of the following:

	2018	2017
ICR from sale of real estate inventory	**1,169,326,743**	459,225,123
ICR from sale of acquired assets	**4,143,599**	4,143,600
Past due ICR	**139,830,368**	165,256,339
	1,313,300,710	628,625,062
Allowance for doubtful accounts	**(165,323,009)**	(165,323,009)
	1,147,977,701	463,302,053

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 1 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.

The increase in ICR from sale of real estate inventory for 2018 includes the P762,307,616 balance from sale of the Iloilo property to a real estate developer in April 2018.

Starting January 2018, all sales of the Marketing and Sales Department of the System's Real Estate Group are on spot cash and one year cash base and maximum two years term for deferred sales in line with the three-year winding down of AFPRSBS.

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

11. INVESTMENT IN BONDS

This account consists of the following:

	2018	2017
Treasury bonds	**2,779,091,843**	4,452,403,407
Retail treasury bonds	**1,629,900,970**	50,000,000
Development Bank of the Philippines (DBP) long-term commercial paper (LTCP)	**500,000,000**	500,000,000
LBP LTCP	**300,000,000**	300,000,000
Corporate bond	**-**	50,000,000
	5,208,992,813	5,352,403,407

The investments earn an average yield of 4.5375 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 (D.O.) 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 GFIs are also eligible brokers under the NRTS.

12. NON-CURRENT INVESTMENTS

This account consists of the following:

	2018	2017
Stock investments	**9,851,502**	21,662,321
MMP	**2,449,903**	2,991,092
	12,301,405	24,653,413

Included in this category is the restricted MMP with DBP in the amount of P2,449,903 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 services was contracted by the System. As of December 31, 2018, the case is still awaiting resolution.

The account also includes financial assets measured at FVOCI which is inclusive of the cumulative unrealized gain/(loss) on financial assets in the amount of (P6,072,944) and P13,058,383 for 2018 and 2017, respectively. All of the stock investments are listed and traded in the Philippine Stock Exchange (PSE) except for the investment in stocks of. Philippine Airlines, Inc. (PAL).

The following table shows the fair value of each investment at the end of the reporting period:

	2018	2017
PSE	**5,184,000**	6,912,000
PAL	**2,839,991**	6,626,216
Premium Leisure Corp. (PLC)	**1,608,000**	2,713,500
Ionics Manufacturing, Inc. (IONICS, Inc.)	**217,200**	267,600
Metro Pacific, Inc. (MPI)	**2,311**	3,411
San Miguel Corporation (SMC)	**-**	4,464,000
Philippine Telegraph and Telephone Corporation (PTT)	**-**	672,094
Metro Alliance Holdings and Equities Corp. (MAH)	**-**	3,500
	9,851,502	**21,662,321**

Dividends on FVOCI equity instruments are recognized in profit or loss when the right to receive payments is established. The following table shows the cash dividends recognized during the period:

Stock	Ex-date	Record date	Date payable	Rate	No. of shares	Amount of dividends
PSE	5-Feb-18	8-Feb-18	6-Mar-18	5.2400	28,800	150,912
PSE	5-Feb-18	8-Feb-18	6-Mar-18	3.7600	28,800	108,288
PLC	6-Mar-18	9-Mar-18	23-Mar-18	0.0439	2,010,000	88,259
MPI	23-Mar-18	28-Mar-18	26-Apr-18	0.0760	498	38
MPI	28-Aug-18	31-Aug-18	25-Sep-18	0.0345	498	17
Total						**347,514**

The System also disposed some of its stock investments as shown on the table below:

Stock	FV at disposal date	FV at last reporting date	Gain on disposal
SMC	5,566,500	4,464,000	1,102,500
MAH	15,000	3,500	11,500
Total	**5,581,500**	**4,467,500**	**1,114,000**

13. ADVANCES TO SUBSIDIARIES AND ASSOCIATES – NET

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

	2018	2017
Bay Resources and Development Corporation (BRADCO)	**12,960,480**	13,191,805
Monterrosa Development Corporation (MDC)	**12,683,745**	12,406,245
MRDC	**5,894,093**	5,894,093
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
	35,387,590	35,341,415
Allowance for doubtful accounts	**(17,837,110)**	(17,837,110)
	17,550,480	17,504,305

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 BRADCO as of December 31, 2016 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.

14. INVESTMENTS IN SUBSIDIARIES – NET

Investments in subsidiaries which are booked at carrying amounts equivalent to the percentage of the entities' net assets or equity consist of the following:

	Percentage of Ownership	2018	2017
Acquisition cost			
MDC	100.00	**873,927,445**	873,927,445
Marilaque Land, Inc. (MLI)	40.00	**609,000,000**	609,000,000
BRADCO	50.00	**402,000,000**	402,000,000
Amtrust Holdings, Inc.	10.92	**127,000,000**	127,000,000
VECI	90.65	**126,738,598**	126,738,598
Aguinaldo Theater Enterprises, Inc. (ATEI)	50.00	**120,000,000**	120,000,000
Resources Investment House, Inc. (RICHI)	100.00	**102,123,549**	102,123,549
Advent Capital and Finance Corporation (ACFC)	14.02	**71,183,811**	71,183,811
MRDC	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. (FDPHI)	00.93	**15,418,269**	15,418,269
Globan Fruits and Development Corporation (GFDC)	100.00	**10,000,000**	10,000,000
SUMSI	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
RSBS Land, Inc. (RLI)	100.00	**994,170**	994,170
		2,563,380,250	2,563,380,250
Net adjustments			
Accumulated equity in net losses, beginning		**(523,645,805)**	(528,555,100)
Adjustment of prior year share in Net Earnings			
Equity in net earnings (losses) for the year		**213,247,289**	211,779,867
Accumulated equity in net losses, ending		**(310,398,516)**	(316,775,233)
Allowance for decline in value		**(453,242,682)**	(453,242,682)
Deferred income		**(196,508,125)**	(196,508,125)
Cumulative liquidating dividends – SUMSI		**(20,500,000)**	(18,000,000)
Liquidating Dividend – RICH & CEMX		**(10,031,947)**	(3,151,447)
		(990,681,270)	(987,677,487)
		1,572,698,980	1,575,702,763

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 P40.400 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 2017, GCG approved the divestment of MDC and SUMSI. In 2018, the bidding process for SUMSI was suspended due to the protest filed by the losing bidder. To date, the System is still awaiting for the opinion from the OGCC on the merits of the protest filed by losing bidder.

15. INVESTMENTS IN REAL ESTATE - NET

This account consists of the following:

	2018	2017
Landbanking assets	**1,771,807,854**	2,333,850,848
Allowance for decline in value of investment in real estate	**(41,559,544)**	(41,559,544)
	1,730,248,310	2,292,291,304

This landbanking assets refers to undeveloped real estate properties of the System located in various parts of the country. These assets are not yet being offered for sale to the public.

16. INVESTMENT PROPERTY – NET

This account consists of the following:

	2018	2017
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	**5,344,000**	5,600,000
	20,142,979	20,398,979

In 2014, the System executed a contract with a lessee for the lease of a 40,000 sq. m 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 P3.200 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.

The minimum rentals for the remaining lease term on the System's operating lease with the said lessee as of December 31, 2018 amounted to P1.305 billion. In 2018, HMRID Property Inc. (HMRID) leased the remaining area of Industrial Park Management Office (IPMO) of 33,762 sq. m more or less, including open spaces, buildings and

improvements found therein for a period of one year effective October 1, 2018 for a rental fee of P3.883 million per month. The BOL, however, approved the extension of the lease contract with HMRID up to three years during the BOL meeting held on February 21, 2019.

Further, the System recorded a percentage rent amounting to P3.896 million for the lease of two parcels of land in Aseana Business Park, Paranaque City to a lessee in 2018. The additional rent was only for a period of four months since the properties/lots were disposed in April 2018.

17. PROPERTY AND EQUIPMENT - NET

This account consists of the following:

	Building improvements	Office equipment	Transportation equipment	Furniture and fixtures	Total
Cost					
Balance, 1/1/2018	91,429,579	149,267,091	8,283,853	15,873,766	264,854,289
Additions (deductions)	-	(2,407,918)	-	(857,136)	(3,265,054)
Balance, 12/31/2018	91,429,579	146,859,173	8,283,853	15,016,630	261,589,235
Accumulated depreciation and amortization					
Balance, 1/1/2018	82,286,621	129,921,154	7,413,036	12,546,958	232,167,769
Depreciation/amortization	-	(2,567,795)	-	(467,416)	(3,035,211)
Balance, 12/31/2018	82,286,621	127,353,359	7,413,036	12,079,542	229,132,558
Net book value, 12/31/2018	**9,142,958**	**19,505,814**	**870,817**	**2,937,088**	**32,456,677**
Net book value, 12/31/2017	9,142,958	19,345,937	870,817	3,326,808	32,686,520

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

18. OTHER NON-CURRENT ASSETS – NET

This account consists of the following:

	2018	2017
Acquired assets *(Note 3.12)*	**490,388,033**	494,842,883
Allowance for probable losses	**(38,960,432)**	(38,960,432)
	451,427,601	455,882,451
Deposits and others	**7,548,483**	7,740,633
	458,976,084	463,623,084

Acquired assets include residential lots, memorial parks, 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. The System, in its letter dated February 23, 2016, has already requested the OGCC 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 April 4, 2017, AFPRSBS sent a letter to the Insurance Commission (IC) 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 Condominium Certificate of Title (CCT) Nos. 51527, 51528, 51528, 51530, and 51534. On December 6, 2018, the System received a letter from the IC conveying the release of mortgage and the return of Owner's Duplicate copies of the five CCTs owned by AFPRSBS subject to compliance with certain requirements. Subsequently, the motion for the lifting/release of bond was filed by the System with RTC, Branch 93, Quezon City on January 25, 2019.

19. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

These accounts consist of the following:

	2018	2017
Trade payables	**150,985,503**	150,530,063
Non-trade payables	**278,628,447**	193,639,559
Accrued employee benefits	**126,363,431**	96,779,295
Reserve for real estate development	**35,030,296**	35,186,631
Accrued operating expenses	**28,611,042**	27,916,961
Payable to real estate brokers	**27,307,418**	20,901,949
Retention payable	**20,823,033**	21,430,096
Buyer's refund payable	**11,644,866**	1,899,289
Payable to landowners	**6,851,650**	6,851,650
Other payables	**9,004,239**	7,025,887
	695,249,925	562,161,380

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

Included in the accrued employee benefits are the accruals made for the provision for employee separation benefits in the total amount of P69.422 million, of which, P32.231 million pertains to accruals for 2018. The amount is net of the P3.786 million separation costs that were paid to 10 separated employees in 2016 and 2017. In August 2018, the BOL approved the separation of 27 personnel on December 31, 2018. The implementation, however, was moved to March 15, 2019 and only 10 personnel out of the 27 was approved to be separated since some of the disposal targets/projections for 2018 were not met.

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 (SRHS) 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.

20. MEMBERS' CONTRIBUTIONS PAYABLE

This account pertains to estimated amount of refund of contributions payable to retiring members of the AFP within 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 retirement. In December 2018, the BOL approved the implementation of the Accelerated Refund of AFPRSBS Members' Contributions (MC). This covers the refund of contribution to an estimated 105,200 members for a period of three years based on length of service, in descending order (first in, first out).

21. 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.

22. ESTIMATED LIABILITY ON EARNINGS OF MEMBERS' CONTRIBUTIONS

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

	2018	2017
Balance at beginning of year	**3,488,286,669**	3,763,101,671
Payments made	**(272,599,792)**	(274,815,002)
Balance at end of year	**3,215,686,877**	3,488,286,669
Current portion	**(1,274,236,641)**	(202,567,785)
	1,941,450,236	3,285,718,884

The System started granting four per cent interest on MCs as per Standard Operating Procedure (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.

In April 2016, the System stopped computing for interests on MCs in compliance with the provision of M.O. No. 90 providing for the abolition of the System.

The current portion of estimated liability on earnings of MCs for 2018 was based on the projected refund payments to be made in CY 2019.

23. FUND EQUITY

Pursuant to P.D. 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, P.D. No. 1656 was promulgated amending certain provisions of P.D. No. 361. Under P.D. 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 Republic Act (R.A.) No. 340 as amended, P.D. No. 1638, as amended by P.D. 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 P.D. No. 1656 amending Section 4 of P.D. 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, P.D. No. 1656 was further amended by P.D. 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 P.D. 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 P.D. 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 P.D. No. 361 whose purpose and function are similar to those of Government Service and Insurance System (GSIS) and Social Security System (SSS).

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 M.O. No. 90.

As of December 31, 2018, the remaining Fund Equity of the System is composed of the P200 million government contributions, retained earnings of P7.573 million and other comprehensive losses of P6.073 million representing the cumulative losses on changes in fair value of stocks. The System's Retained Earnings account drastically increased in 2018 due to the disposal of seven major assets and the stoppage of the accrual of interest on members contributions effective March 2016.

24. 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 P.D. 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 P.D. 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 B.R. No. SPL -01-2016. Hence, no new contributions were received by the System, except for some supplementary contributions pertaining to prior months *(See Notes 20 and 22).*

25. REVENUES

Revenues consist of the following:

	2018	2017
Real estate operations		
Sale of real estate inventories - net	**5,282,758,512**	126,667,298
Income from acquired assets - net	**3,211,531**	8,841,330
Other income	**15,721,626**	7,066,062
	5,301,691,669	142,574,690

	2018	2017
Fund management operations		
Income from long-term investments	**199,804,776**	174,712,878
Interest on MMP/deposit in banks/treasury bills	**122,534,966**	18,291,639
Gain (loss) on sale of stocks	**1,114,001**	-
Income from stocks/dividends	**347,514**	12,889,891
	323,801,257	205,894,408
Real estate rentals		
Rentals from IPMO - net	**104,292,865**	102,442,324
Rentals from real estate properties - net	**13,897,812**	25,645,128
	118,190,677	128,087,452
Lending operations		
Interest on ICRs	**64,803,463**	21,693,094
Interest on advance refunds	**10,500,469**	33,034,245
Interest on commercial loans	**3,668,660**	2,573,840
Interest on employee loans	**650,122**	682,170
Interest on discounting of commutation of leave	**78,899**	66,775
Interest on multi-purpose loans	**-**	20,437
Other income	**8,887,078**	253,587,849
	88,588,691	311,658,410
Equity holdings in subsidiaries and associates	**6,376,717**	211,779,867
	5,838,649,011	999,994,827

26. DEPRECIATION AND AMORTIZATION

This account consists of the following:

	2018	2017
Property and equipment	**552,557**	1,444,383
Investments in real estate	**2,700,437**	2,700,437
	3,252,994	4,144,820

27. 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.

28. EMPLOYEE BENEFITS

Included in the accrued employee benefits are the accruals made for the provision for employee separation benefits in the total amount of P69.422 million, of which, P32.231 million pertains to accruals for 2018. The amount is net of the P3.786 million separation costs that were paid to 10 separated employees in 2016 and 2017. In August 2018, the BOL approved the separation of 27 personnel on December 31, 2018.

29. 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:

	2018	2017
Receivables *(Note 6)*	**2,673,074**	3,073,074
Receivable from joint venture partner *(Note 6)*	**20,127,108**	19,634,664
Loans receivable *(Note 7)*	**80,527,822**	61,918,478
Advances to subsidiaries and associates *(Note 13)*	**35,387,590**	35,341,415
Accounts payable and accrued expenses	**131,216,958**	99,142,024
	269,932,552	219,109,655

30. CONTINGENCIES

The System was summoned in 1998 by the Senate Committees on Accountability of Public Offices and Investigation (Blue Ribbon) and National Defense and Security (NDS), joined by the Joint Committees on Banks and Financial Institutions and Currencies and NDS, 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.

31. RETAINED EARNINGS

The Retained earnings was presented as net of prior period adjustments to reflect sales and expense transactions of prior years. Starting the year 2016, the System has already stopped the charging of the interests earned by the contributions of the members from the Retained earnings. Movements in the account are as follows

	2018	2017 (As restated)
Balance, January 1	1,872,229,130	987,483,703
Correction of prior period errors	-	477,750,411
Profit for the year	5,704,036,707	406,995,016
	7,576,265,837	**1,872,229,130**

The correction/adjustment of prior years' errors consists of the following: (a) adjustments on the Retained Earnings account which represent the waived penalty for the borrower's account amounting to P248.607 million, net share in the increase of the System's subsidiaries net assets of P206.871 million, interest income on Discounted Members' Refund of P17.020 million; and (b) recognition of other income from fund management operations and real estate operations and other expenses amounting to P5.253 million as presented in the statement of changes in equity.

32. RECONCILIATION OF LIABILITIES ARISING FROM FINANCING ACTIVITIES

Liabilities to the members	**2018**
Balance, January 1, 2018	13,732,131,791
Cash flows from financing activities:	
Payment of contributions	(541,937,871)
Non-cash financing activities:	
Adjustment of matured loans/others	(371,915,070)
Balance, December 31, 2018	**12,818,278,850**

33. RECLASSIFICATIONS AND RESTATEMENTS

33.1. Reclassifications

The following accounts pertaining to CY 2017 were reclassified to be comparable with CY 2018 figures:

	From	To	Amount
Reclassification of Investments in real estate to Real estate inventories	Investments in real estate	Real estate inventories	4,114,940,236
Reclassification of investment in PAL shares from Investments in subsidiaries (previously Investment in shares of stocks) to Non-current investments	Investments in subsidiaries	Non-current investments	6,626,216

33.2. Restatements

Below is the summary of the financial impact of the restatement of the 2017 financial statements:

Prior period adjustments	Income	Expenses	Assets	Liabilities	Net worth
Recording of capitalized waived penalty from a borrower	248,606,654	-	248,606,654	-	248,606,654
Adjustment of Investment in subsidiaries account to effect the increase in net asset of the subsidiaries	206,870,572	-	206,870,572	-	206,870,572
Adjustment of prior period error on unearned interest income related to discounted members refund	17,019,953	-	-	(17,019,953)	17,019,953
Recording of prior period adjustment on the sale of stocks	11,788,007	505,500	-	-	-
Other adjustments	(5,931,880)	97,396	-	6,534,775	(6,534,775)
	478,353,306	602,896	455,477,226	(10,485,178)	465,962,404

34. EXEMPTION FROM TAX

Pursuant to Section 2(c) of P.D. No. 361, as amended by P.D. 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 (NIRC). The latest affirmation was issued on August 11, 2009.

35. COMPLIANCE WITH REVENUE REGULATIONS (R.R.) NO.15-2010

In compliance with the requirements set forth by BIR R.R. No. 15-2010, hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year 2018.

35.1. Withholding Taxes

	2018	2017
Tax on compensation and benefits	**7,070,608**	9,761,816
Value-added taxes	**2,580,794**	3,262,964
Expanded withholding taxes	**3,491,714**	4,943,011
Percentage taxes	**68,766**	67,378
	13,211,882	18,035,169

35.2. Other Taxes

	2018	2017
Local		
Real estate taxes	**27,192,435**	14,563,283
Capital gains taxes	**408,284,449**	12,659,922
Transfer taxes/Others	**323,495**	417,510
National		
BIR annual registration	**500**	500
	435,800,879	27,641,215

As of December 31, 2018, no Preliminary Assessment Notice (PAN), Final Assessment Notice (FAN) nor Formal Letter of Demand (FLD) was issued by BIR against the System for any non-payment of tax or deficiency tax.

36. STATUS OF LAWSUITS

The System is involved as a defendant in several lawsuits pending for resolution that could materially affect its financial position. Among these lawsuits are the following:

Case No./Court	**Description**	**Pecuniary amount or liability involved**	**Status**
RTC, Branch 10, Davao City March 12, 1997	Specific Performance, Injunction & Damages arising from the property bought by AFPRSBS from co-defendant which were	P15.200 million	The RTC decided against the defendants. The Office of Solicitor General appealed the said decision before CA.

Case No./Court	Description	Pecuniary amount or liability involved	Status
CA, Cagayan de Oro CA-G.R. CV No. 02822-MIN	allegedly sold to the plaintiff.		CA rendered decision last October 21, 2016. AFPRSBS filed MR to said decision on November 17, 2016. Petition for Certiorari was filed by the Office of Solicitor General before the SC on June 19, 2018.
Civil Case No. 988 RTC, Nasugbu, Batangas	Reconveyance of property with damages in relation to the joint venture entered into by AFPRSBS and a developer for the construction and marketing of a 28 storey condominium building.	P870.170 million	Decision rendered in favor of GDI. The OGCC, on behalf of the defendants, filed the appeal to the CA on June 9, 2017.

The System is likewise involved as party litigant to 13 pending ejectment cases while 18 ejectment cases are for execution/implementation. There are other 14 Land Registration Authority (LRA)/Reconveyance/Reconstitution cases which are still pending. Moreover, among the HLURB related cases, 27 are still pending while 28 are for execution. In other civil cases, three are still pending while two are for execution. Other pending cases, as such: four expropriation cases, one Comprehensive Agrarian Reform Program case, four Criminal cases, and one labor case. Lastly, there are 31 various cases being handled by the OGCC.