

## OBSERVATIONS AND RECOMMENDATIONS

**1. The System's financial statements were not consolidated with the financial statements of its subsidiaries and controlled entities where it has invested a total of P2.546 billion. Moreover, the investment account is overstated by P10.828 million due to failure to eliminate reciprocal accounts. Hence, the said financial statements do not present a reliable and accurate financial conditions and the results of its operations as of and for the year ended December 31, 2014 contrary to pertinent provisions of Philippine Financial Reporting Standards (PFRS) 10.**

1.1 PFRS 10 – Consolidated Financial Statements sets the requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate entities it controls.

1.2 Paragraph Nos. 4, 19 and 21 of the above Standards provides:

*Paragraph 4 requires an entity that is a parent to present consolidated financial statements except if it meets all of the following conditions:*

- a. It is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;*
- b. Its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);*
- c. It did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and*
- d. Its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with PFRSs.*

*Paragraphs 19 and 21 requires a parent to prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances and that in preparing consolidated financial statements, a parent shall:*

- a. Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries;*
- b. Offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.*
- c. Eliminate in full intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group.*

Paragraph 21 further provides that the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months.

1.3 The financial statements of AFPRSBS and its accompanying notes as at December 31, 2014 disclosed that the System has a total investments in stocks of its subsidiaries and affiliates/controlled entities totalling P2,545,784,000 as follows:

Subsidiaries and Controlled Entities	% of Ownership	Cost of Investment	
		2014	2013
Monterrosa Development Corporation*	100.00	873,927,445	873,927,445
Resources Investment House*	100.00	102,123,549	102,123,549
RSBS Land, Inc.*	100.00	70,000,000	70,000,000
Fashion Link Corporation*	100.00	20,100,000	20,100,000
Southern Utility Management Services, Inc.*	100.00	10,000,000	10,000,000
General Satellite Communications, Inc.*	62.00	2,906,238	2,906,238
AFP Theater Enterprises, Inc.*	50.00	120,000,000	120,000,000
Bay Resources Development Corporation*	50.00	402,000,000	402,000,000
Amtrust Holdings, Inc.*	25.56	127,000,000	127,000,000
Sub-Total		1,728,057,232	1,728,057,232
Matrix Realty Development, Corporation	100.00	35,931,250	35,931,250
Globan Fruits & Development Corporation	100.00	10,000,000	10,000,000
RSBS Enterprises, Inc.	100.00	2,500,000	2,500,000
Veterans Electronics Communications	90.65	126,738,598	126,738,598
Goodfit Manufacturing Corporation	79.99	25,556,920	25,556,920
Marilaque Land, Inc.	40.00	609,000,000	609,000,000
Cyquest Incorporated	40.00	2,000,000	2,000,000
CEMX, Inc.	24.00	6,000,000	6,000,000
Sub-Total		817,726,768	817,726,768
<b>Total</b>		<b>2,545,784,000</b>	<b>2,545,784,000</b>

Annex A for the addresses of the Subsidiaries

a. The System did not submit the financial statements of its foregoing nine subsidiaries and affiliates where it has invested a total of P1,728,057,232\* as well as the detail of the accumulated equity in net losses of its subsidiaries and affiliates amounting to P533,391,765 per note 10 to financial statements, to

prove the correctness of the balances of the said accounts as at December 31, 2014.

b. Moreover, the financial statements submitted by the remaining eight subsidiaries and affiliates do not have the same reporting date as that of the System contrary to Paragraph 21 of PFRS 10. No additional information to update the financial statements was provided to properly consolidate the financial information of the subsidiaries and affiliates.

1.4 Note 3.7 to the financial statements states that the System's investments in subsidiaries and associates are accounted for under the equity method or cost method depending on whether the System has or has no significant influence over the investee. Under the equity method, the System recognizes in its statement 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.

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

1.6 The said justification is not among the conditions provided under Paragraph 4 of PFRS 10 that will qualify the System for exemption from presenting the line by line consolidation of its financial statements with the financial statements of its subsidiaries.

1.7 The System also failed to eliminate the parent and subsidiary reciprocal account balances of P28,665,153 and its allowance for doubtful accounts of P17,837,020 contrary to Paragraph 21 of PFRS 10, thereby overstating the net asset account balance by P10,828,133 as follows:

		<b>2014</b>		<b>2013</b>
Bay Resources Development Corp. (BRADCO)	P	9,179,341	P	9,179,341
Monterrosa Development Corp. (MDC)		10,981,245		10,152,495
Matrix Realty and Development Corp. (MRDC)		5,894,093		5,894,093
Veterans Electronics Communications, Inc.		1,768,761		1,768,761
Southern Utility Mgt. & Services, Inc. (SUMSI)		841,713		841,713
		28,665,153		27,836,403
Allowance for doubtful accounts		(17,837,020)		(17,837,020)
		<b>P 10,828,133</b>		<b>P 9,999,383</b>

1.8 In view of the foregoing, the financial statements of the System do not present a true and reliable representation of its financial condition and the results of its operations as of and for the year ended December 31, 2014.

- 1.9 **We reiterated our prior year's recommendation that Management:**
- a. **Prepare the consolidated financial statements to include the assets, liabilities and results of operation of its subsidiaries;**
  - b. **Eliminate all parent and subsidiary reciprocal account balances during the process of consolidation;**
  - c. **Disclose the status of the financial standing of said subsidiaries and its investment thereon; and**

1.10 **We further recommended that Management prepare the Statement of Affairs and the Statement of Realization and Liquidation of those subsidiaries and affiliates that are already closed and submit them to COA for audit until all its assets are realized; all its liabilities are settled; and the concerned subsidiaries and affiliates are fully liquidated/dissolved in accordance with the pertinent rules and regulations of SEC.**

1.11 Management commented that the required consolidated financial statements of its actively operating subsidiaries cannot be provided at this time for the reason that the audited financial statements (AFS) for the year ending 31 December 2014 are still unavailable. Aside from the fact that they have different reporting periods, these GOCCs are required to have their respective AFS filed before the Bureau of Internal Revenue (BIR) and the Securities and Exchange Commission (SEC) prior to distribution.

For the inactive subsidiaries and affiliates who have ceased operations during the prior years, there is a need to undertake a thorough evaluation of each account based on available documents to enable the Equity Investment and Management Department (EIMD) to come up with suitable recommendations if they are feasible for dissolution or write-off. EIMD has already secured from SEC a copy of the last AFS and General Information Sheet of other subsidiaries and affiliates which have ceased operations/non-operating companies.

On 22 October 2014, EIMD has secured the Dissolution Order of RSBS Land, Inc. (RLI) rendering the subsidiary dissolved effective 31 December 2014. Thereafter, the turnover of all the receivables and remaining assets in the books of RLI to AFPRSBS, is currently being undertaken.

EIMD is also coordinating with the respective corporate secretary/officer/director of the subsidiaries on the latest developments of each account. Most of the actively operating subsidiaries and affiliates are operating at a loss except for Southern Utility Management and Services, Incorporated.

As to the preparation of the Statement of Affairs and the Statement of Realization and Liquidation, EIMD is presently undertaking efforts to gather significant documents and information highlighting the assets at their liquidation values and liabilities of the companies whose bankruptcy are imminent.

1.12 By way of rejoinder, we acknowledge the difficulties faced by the System in preparing a reliable set of financial statements, however, those constraints cannot be used as a justification for them to be exempted from the consolidation of financial statements required by Paragraph 21 of PFRS 10. As long as the System has the ability to exercise control over the entities it has significant stock investments, it must consolidate the financial statements of these entities with its own to present a true and reliable representation of its financial condition and results of its operations.

*Industrial Park Management Office (IPMO)*

**2. Three lessees of the IPMO did not execute contracts with RSBS, contrary to COA Circular No. 88-282 A, while four lessees did not comply with Sections 3.3.2 and 3.3.3 of the existing lease contracts on the timely remittance of rental payments. Moreover, all the lease contracts lack provision as to the date and time of payment of the monthly management dues contributing to accumulation of receivables, thus, prejudicial to the interest of the System.**

2.1 Section 3.3.2 of all the lease contracts with lessees requires that payment of monthly rentals should be made at or before noon of the 5<sup>th</sup> regular business day of the month. Relative thereto, Section 3.3.3 of all the lease contracts provides that any delayed payment of rentals shall be subject to penalties by way of interest computed at 2 ½ per cent per month of the total sums due and unpaid as of the day of delay.

2.2 In the absence of contract, conditions of the lease may not be enforceable as provided for and defined by Article 1403 of Republic Act (R.A.) No. 386, otherwise known as the New Civil Code of the Philippines, as follows:

*“Article 1403. The following contracts are unenforceable unless they are ratified:*

*xxx*

*(2) Those that do not comply with the Statute of Frauds as set forth in this number.*

*xxx:*

*(a) An agreement for the leasing for a longer period than one year, or for the sale of real property or of an interest therein; xxx.”*

2.3 The absence of contracts also violates Section 2 of COA Circular No. 88-282 A dated March 3, 1988 on Uniform Standards/Guidelines to determine the Reasonableness of the Terms and Rental Rates of Lease Contracts for Private or Government which provides that:

*“The contract of lease shall be embodied in a public instrument and shall integrate all the covenants, understanding and agreements of the lessor and the lessee. xxx.”*

2.4 The AFP-RSBS IPMO, located in Taguig City, was acquired through a land grant by virtue of Proclamation No. 1218 dated May 8, 1998 issued by then President Fidel V. Ramos. It consists of three parcels of land with a total area of 90,249 sqm. Currently, the System leases the IPMO's facilities and open spaces to several lessees.

2.5 The list of tenants as of February 2015 provided by IPMO showed that there are 24 facilities and all are occupied. Review of the lease contracts showed the following:

- a. Cavallino, Inc. – a 250 sqm. office facility of the IPMO is being leased and occupied by Cavallino, Inc. without a duly signed and notarized lease contract. Previous contract with the lessee expired on February 2014, inclusive of the “one-time” one year automatic extension of the lease term.

Verification from the Property Management and Enhancement Department (PMED) revealed that when the lease term ended in February 2014, Cavallino, Inc. did not surrender the leased property but continually occupied it offering that payments under the old lease contract will be observed. Subsequent thereto, in November 2014, the lessee notified the PMED of its intent to enter into a new lease agreement. However, as of this writing, the new lease contract is still being finalized.

- b. GLJR Catering Services (GCS)/Tres Angelos Catering (TAC) – review of the rental income recognized during the year disclosed that P134,820.00 was accrued for GLJR Catering Services (GCS). No copy of the lease contract relative to this lease was submitted for review by the Controllershship Department (CD) nor the PMED.

Upon verification, PMED explained that only a draft three year lease contract was prepared on the lease by GCS who vacated the facility in 2013. A new tenant, Tres Angelos Catering (TAC), took over the use of the leased facility roughly two months after GCS left. PMED further stated that no lease contract was executed relative to this lease. On the other hand, the CD still bills GCS for the monthly rentals which should have been made for the account of TAC in the absence of notice from the PMED.

2.6 Further review of the RSBS records revealed that four lessees with existing contracts were delayed by one to three months in paying their monthly rentals as of December 31, 2014. The CD informed that the contractually agreed penalties for the delayed payments were not yet imposed and collected as of February 2015, from the following:

Lessee	Current Monthly Rent	Rent Receivable as of 12/31/2014
High Performance Solutions, Inc.	P 166,995	P 730,297
Broadchem Philippines	47,080	129,941
Meat Plus Specialists Philippines, Inc.	33,438	100,308
Bakemasters, Inc.	37,878	73,728
<b>Total</b>		<b>P 1,034,274</b>

2.7 Likewise, seven lessees with existing contracts with the System have monthly management dues outstanding from one month to over a year as at year-end amounting to P298,240. Review of the lease contracts disclosed that the contracts contain no express stipulation as to the date and time of payment of the management dues and any imposition of penalties for delay in payment thereof. Upon inquiry, PMED explained that while there is no such stipulation in the contract, the Statements of Account sent to the lessees include the demand for payment of the management dues though no penalty was imposed for any delayed payment, detailed as follows:

Lessee	Management Dues/Month	Dues Receivable as of 12/31/2014
Freesurf, Inc.	P 11,430	P 182,880
Bakemasters, Inc. – 750 sqm.	6,000	40,500
High Performance Solutions, Inc.	6,300	37,800
Men in Blue Security Services, Inc.	2,112	16,180
Prime Sales, Inc.	1,950	7,800
Bakemasters, Inc. – 442.5 sqm.	3,540	7,080
Meat Plus Specialists Phils Inc.	2,000	6,000
		<b>P 298,240</b>

2.8 The System tends to lose a total of P1.333 million for its operations if these dues and receivables from IPMO lessees are not collected.

2.9 **We recommended that Management require the PMED to:**

- a. **Execute a duly signed and notarized lease contract before turning over the property to a lessee in compliance with Article 1403 of RA No. 386 and COA Circular No. 88-282A;**
- b. **Ensure that for renewals of lease contracts, a new contract should be executed either with the existing lessee or a new tenant prior to the expiration of the lease term with the former;**
- c. **Improve coordination with the CD to avoid discrepancies in billing and accruing monthly rentals;**
- d. **Strictly monitor the observance/implementation of the stipulations in the lease contracts for the benefit of the System;**
- e. **Impose on time the agreed penalty and interest on the delayed remittance of the four lessees; and**
- f. **Incorporate in subsequent lease contracts the date and time of payment of the monthly management dues and the imposition of penalties for any delay in payment thereof.**

2.10 Management commented as follows:

***On the Contract of Cavallino, Inc.***

Property Management and Enhancement Department (PMED) affirms that the draft Lease Contract passed hands between the two parties due to some disagreements in the provisions. Finally in November 2014, the parties reached an agreement at which time Cavallino Inc. submitted the final version of the mutually agreed upon contract which is for review by the Legal Department.

During the period of extension and afterwards, lease rate is subjected to a 10 per cent increase annually as provided for in Section 3.1.2.

***On the Contract of GLJR Catering Services (GCS)/Tres Angelos Catering (TAC)***

There was no lease contract executed to document the contract with GCS considering that the Conforme letter was never returned despite repeated follow-ups. GCS left the operations of the canteen to its partner, TAC, which assumed the canteen operation and payment of the lease rentals.

PMED and CD will validate and reconcile payments of Bakemaster Inc, Broadchem Philippines, High Performance Solutions, Inc. and Meat Plus Specialists Phils Inc.. Applicable penalties will be collected from the said tenants once the records are reconciled.

PMED maintains that management dues are billed in consonance with the rental billing and is reflected in the tenant's monthly billing statements sent. Anent delays in payment of management dues of various lessees, PMED will likewise reconcile records with CD and will subsequently collect these from tenants if it is established that these are indeed unpaid rentals and management dues.

Also, the lease contract shall be referred to Legal Department for review on the imposition of penalties on management dues for late payment.

2.11 As a rejoinder, we maintain our stand that the System comply with the above recommendations to obtain the most from its leases in the IPMO and lessen its risk exposure, for the benefit of its members. While there are unfavorable events that may arise from time to time, the System can address those conditions without prejudice to its interest and that of its members. Moreover, prepare a timetable to enforce all provisions of the contract and to accomplish its planned goals.

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



3.1 VAT are taxes on consumption levied on the sale, barter, exchange or lease of goods or properties and services in the Philippines and on importation of goods into the Philippines. The seller is the one statutorily liable for the payment of the tax but the amount of the tax may be shifted on to the buyer, transferee or lessee of goods or services.

3.2 Section 105 and 108 of Republic Act (R.A.) No. 8424, otherwise known as Tax Reform Act of 1997, as amended by RA No. 9337, relative to the imposition of VAT on sale of services and use or lease of properties, provides that:

**“Section 105. Persons Liable.** – Any person who, in the course of trade or business sells, barter, exchanges, leases goods or properties, renders services, and any person who imports goods shall be subject to the value-added tax imposed in Sections 106 to 108 of this Code.

*The phrase ‘in the course of trade or business’ means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a non-stock, non-profit private organization (irrespective of the disposition in its net income and whether or not it sells exclusively to members of their guests) or government entity.*

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**Section 108. Value-added Tax on Sale of Services and Use or Lease of Properties.** –

**(A) “Rate and Base of Tax.** – There shall be levied, assessed and collected, a value-added tax equivalent to 10% of gross receipts derived from the sale or exchange of services, including the use or lease of properties: Provided, That the President, upon recommendation of the Secretary of Finance, shall, effective January 1, 2006, raise the rate of value-added tax to twelve-percent (12%), xxx

xxx

*Lease of properties shall be subject to the tax herein imposed irrespective of the place where the contract of lease or licensing agreement was executed if the property is leased or used in the Philippines.*

*The term ‘gross receipts’ means the total amount of money or its equivalent representing the contract price, compensation, service fee, rental or royalty, including the amount charged for materials supplied with the services and deposits and advanced payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person, excluding value-added tax.”*

3.3 On exemptions from VAT, Section 109 of R.A. No. 8424, as amended by RA No. 9337, provides that:

**“Section 109. Exempt Transactions.** – *The following shall be exempt from the value-added tax:*

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(Q) *Lease of a residential unit with a monthly rental not exceeding Ten thousand pesos (P10,000) Provided, That not later than January 31, 2009 and every three (3) years thereafter, the amount herein stated shall be adjusted to its present value using the Consumer Price Index, as published by the National Statistics Office (NSO);*

xxx

(Z) *Sale or lease of goods or properties or the performance of services other than the transactions mentioned in the preceding paragraphs, the gross annual sales and/or receipts do not exceed the amount of One million five hundred thousand pesos (P1,500,000); Provided, That not later than January 31, 2009 and every three (3) years thereafter, the amount herein stated shall be adjusted to its present value using the Consumer Price Index, as published by the National Statistics Office (NSO); xxx”*

3.4 Meanwhile, Section 9.236-1 of Revenue Regulations No. 16-2005 on Consolidated Value-added Tax Regulations of 2005 requires that:

**“SEC. 9.236-1. Registration of VAT Taxpayers –**

(a) *In general. – Any person who, in the course of trade or business sells, barter, exchanges goods or properties, or engages in the sale of services subject to VAT imposed in Secs. 106 and 108 of the Tax Code shall register with the appropriate RDO using the appropriate BIR forms and pay an annual registration fee in the amount of Five Hundred Pesos (P500) using BIR Form No. 0605 for every separate or distinct establishment or place of business (save a warehouse without sale transactions) before the start of such business and every year thereafter on or before the 31<sup>st</sup> day of January.*

xxx

(b) *Mandatory:*

*Any person who, in the course of trade or business, sells, barter or exchanges goods or properties, or engages in the sale or exchange of services shall be liable to register if:*

- i. His gross sales or receipts for the past twelve (12) months, other than those that are exempt under Section 109 (1)(A) to (U) of the*

*Tax Code, have exceeded One million five hundred thousand pesos (P1,500,000.00); or*

- ii. There are reasonable grounds to believe that his gross sales or receipts for the next 12 months, other than those that are exempt under Section 109 (1)(A) to (U) of the Tax Code, will exceed One million five hundred thousand pesos (P1,500,000.00).*

*Every person who becomes liable to be registered under paragraph (1) of this subsection shall register with the RDO which has jurisdiction over the head office or branch of that person, and shall pay the annual registration fee prescribed in subsection 9.236-1(a) hereof. If he fails to register, he shall be liable to pay the output tax under Sections 106 and/or 108 of the Tax Code as if he were a VAT-registered person, but without the benefit of input tax credits for the period in which he was not properly registered. xxx”*

3.5 Amending certain provisions of RR No.16-2005, Section 1 of RR No. 16-2011 states that:

*“Section 1. BACKGROUND. Sections 109(P), (Q) and (V) of the Tax Code of 1997, as amended provides that the amounts stated therein shall be adjusted to their present values using the Consumer Price Index as published by the National Statistics Office (NSO).*

*xxx*

*the adjusted threshold amounts, rounded off to the nearest hundred are as follows:*

<b>Section</b>	<b>Amount in Pesos (2005)</b>	<b>Adjusted Threshold Amounts</b>
Section 109 (P)	P 1,500,000	P 1,919,500
Section 109 (P)	2,500,000	3,199,200
Section 109 (Q)	10,000	12,800
Section 109 (V)	1,500,000	1,919,500

3.6 The System leases its Industrial Park in Taguig City, to various tenants. Records disclosed that the System collected roughly P30,000,000 from its leasing activities for CY 2014 exceeding the threshold set by law for an entity to be mandatorily required to register under the VAT system.

3.7 Records showed that it did not impose and collect VAT on its gross receipts from the lease of its properties. Further, per the System’s BIR Registration under OCN No. 3RC0000601748, AFPRSBS is not registered under the VAT system.

3.8 The CD and the Legal Department said that they are non-VAT registered as the System is exempt from VAT payment. However, they were unable to present a VAT Exemption Certificate (VEC) from the Bureau of Internal Revenue to prove their claim.

3.9 Further, none in R.A. No. 8424, as amended, exempts the lease transactions of the System from VAT. A cursory reading of the System's Charter, P.D. No. 361, as amended, also shows that no provision thereof specifically exempts it from imposing and collecting indirect taxes such as VAT.

3.10 In view of the above circumstances, it is unjustifiable for the System not to register itself as a VAT-registered entity without any express statutory authority. Not complying with the provision of tax laws, rules and regulations in relation to VAT exposes the System to possible administrative and criminal sanctions in addition to significant monetary penalties.

3.11 Meanwhile, since the System claimed to be VAT exempt and is non-VAT registered, it incorrectly imposed and collected VAT in the amount of P886,480 on the contingent rental payment of PSMT Philippines, Inc. during the current year. R.A. No. 8424, as amended, allows VAT-registered entities only to charge VAT on their sale of services and use or lease of properties. The System, being non-VAT registered at the time of collection, cannot legally do the same.

3.12 **We recommended that Management:**

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

3.13 Management commented that all income derived from its various business operations are tax-exempt by virtue of the ruling issued by the BIR dated 01 August 2005. Tax compliance of RSBS, being a government entity, is limited only to the remittance to BIR of the withholding taxes from purchase of goods and services from its suppliers, consultants, brokers and contractors.

The income tax exemption that was granted to the System was eventually then considered to mean as an exemption as well for all types of taxes, to include VAT, which may be imposed upon the transactions of the System. In addition, the System has no previous history that it has been assessed by the BIR for non-payment of VAT or non-filing of VAT.

With the current concern on VAT raised by COA, the System will coordinate with the proper authorities to address the issue in order to avoid any tax liability that may be charged due to non-imposition of the same on its transactions.

On the VAT that was erroneously imposed on and collected from the contingent rental payment of PSMT Philippines, Inc., the System shall hold the same in trust until the issue of VAT exemption and eventual refund shall have been resolved.

3.14 By way of rejoinder, while we recognize the income tax exemption of the System, we strongly believe that such does not extend to exemption from VAT contrary to what the management proffers. It should be noted that VAT is not an income tax, the former is an indirect tax while the latter is a direct tax. Hence, the System can only be exempted from VAT if its transactions meets any of those listed in the National Internal Revenue Code.

**4. The recognition and the non accrual of rental income based on the amount received or to be received from the lessees is not in accordance with pertinent provisions of Philippine Accounting Standards (PAS) 17 – Leases, thus understating the reported income for the current year by P7.670 million. Likewise, the required disclosures of the Standard relative to the System’s operating leases are not provided for in the Notes to Financial Statements.**

4.1 PAS 17 prescribes for lessors and lessees, the appropriate accounting policies and disclosures to apply in relation to leases. For recognition purposes, the Standard classifies leases into finance leases and operating leases depending on the extent of risks and rewards transferred to the lessee.

4.2 An **operating lease** does not transfer substantially all the risks and rewards incidental to ownership. Thus, in an operating lease, the lessor still recognizes the leased asset in its books, depreciates the asset in accordance with its policies and records the monthly rent as income whereas the lessee accounts for the lease payments as expense as part of its operating costs.

4.3 In relation to rentals received under operating leases, Paragraphs 50 and 51 of PAS 17, provides that:

*“50. Lease income from operating leases shall be recognized in income on a straight-line basis over the lease term, unless another systematic basis is more representative of time pattern in which use benefit is derived from the leased asset is diminished.*

*51. xxx Lease income (excluding receipts for services provided such as insurance and maintenance) is recognized in a straight-line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from leased asset is diminished.”*

4.4 Paragraphs 1 and 4 of SIC Interpretation No. 15 on Operating Leases – Incentives provides further that:

*“1. In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an upfront cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee xxx. Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent.*

xxx

*4. The lessor shall recognize the aggregate cost of incentives as a reduction of rental income over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern over which the benefit of the leased asset is diminished.”*

4.5 Additionally, leases may provide for rental payments that are not fixed in amount but is based on future amount of a factor that changes other than with the passage of time such as percentage of future sales, amount of future use, future price indices and future market rates of interest. In recognizing these contingent items, Paragraph 25 of PAS 17 provides that “*contingent rents shall be charged as expenses in the periods in which they are incurred.*” Conversely, contingent rent received by lessors shall be recognized as income in the period they are earned.

4.6 During CY 2014, the System had 32 significant outstanding lease agreements with several lessees most of which provides for escalation of rental payments ranging from five to ten per cent annually or every other year with one agreement providing for a rent-free period of 80 days. An examination of said agreements disclosed that all are in the nature of operating leases and they were appropriately accounted for as such.

4.7 However, further scrutiny of the System’s records revealed that the CD recorded the amount received or to be received from the lessees as rental income which runs counter to the straight-line basis as provided under Paragraph 50 of PAS 17. The said method distributes equally over the lease term the total expected payments from the leases. Non-compliance with said provision of PAS 17 resulted in an understatement of the Rental Income for 2014 and the balance of the Accounts Receivable, Trade – Lessees as of December 31, 2014 by P7,514,189 (Annex B).

4.8 The computation, however, does not include yet the understatement brought about by the non-compliance with PAS 17 in 2012 and 2013 which was not possible as the details of the rental income for 2012 and 2013 were not made available by the CD.

4.9 In addition, several errors were committed in recognizing the System’s rental income from its lease contracts with PSMT Philippines, Inc. (PSMT) and Southern Utility Management and Services, Inc. (SUMSI), to wit:

- a. Inadvertently included in current year rental income were the contingent rents for 2012 and 2013 of P1,255,932 and P6,131,403, respectively. Payment of these contingent rents is provided for under Section 3.3 of the lease contract.
- b. The contingent rent for 2014 and the annual additional rent from PSMT of \$1,250.00 per year (translated at P55,763 for 2014) were not booked as income and receivable as of December 31, 2014. Relative to the additional rent, the same was recorded as income upon receipt in January 2015.
- c. The value-added tax (VAT) imposed and collected by the System on the contingent rents for 2012 and 2013 totaling P886,480 was credited as rental income when the same should have been recorded as a liability.

d. The rental income recognized for SUMSI for 2014 was only P1,100,000. However, inspection of the lease contract with SUMSI disclosed that the agreed annual rental is P1,200,000. Hence, P100,000 worth of rentals should have been accrued at year-end.

4.10 The CD reasoned that it was just in the current year that the IPMO was able to collect the contingent rents due from PSMT. The Summary of Sales Report (SSR) of PSMT from 2006 to 2013 was received only in September 2014. Also, the SSR for 2014 is still not received by the System as of this writing. Hence, the non-accrual of the contingent rent for 2014 as of December 31, 2014. As for the other errors, the CD is amenable to their lapses.

4.11 Regardless of the timing of receipt of the SSR from PSMT, the System should recognize the contingent rent as income when they are earned and not when they are received. Further, the System should bear in mind that PSMT has to pay the contingent rent on or before the 60<sup>th</sup> day after the expiration of each lease year under Section 3.05 of the lease contract. Non-payment of the same on the agreed period constitutes breach of contract. Moreover, the late payment of the contingent rent deprives the System of the opportunity to use the same for other purposes.

4.12 Meanwhile, Paragraph 56 of PAS 17 provides for the disclosure requirements for lessors, as follows:

*“56. Lessors shall, in addition to meeting the requirements of IFRS 7, disclose the following for operating leases:*

*(a) The future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods:*

- (i) Not later than one year;*
- (ii) Later than one year and not later than five years;*
- (iii) Later than five years.*

*(b) Total contingent rent recognized as income in the period.*

*(c) A general description of the lessor’s leasing arrangements.”*

4.13 The foregoing required disclosures in the Notes to financial statements were not included in the CY 2013 and 2014.

4.14 **We recommended that Management:**

**a. Adopt the straight-line basis of recognizing rental income from operating leases as mandated by PAS 17;**

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

**c. Prepare the necessary adjusting journal entries to:**

- i. Reflect the adoption of and compliance with PAS 17 through an adjustment of the reported rental income for 2014 and the reported year-end AR, Trade – Lessees; and**
- ii. Correct the errors committed in recording lease income for 2014 as discussed in Paragraphs 4.9 (a) to (d);**
- d. Strictly monitor the observance of PSMT with the provisions of its lease contract with the System specifically on timely reporting and payment of the contingent rent;**
- e. Estimate and book at every year-end the contingent rent from PSMT regardless of the receipt of the SSR; and**
- f. Include in the Notes to Financial Statements the required disclosures relative to the System’s operating leases.**

4.15 Management commented that it will comply to COA’s recommendation. The CD will review the contracts and schedules of the recorded rental income for the years 2012 and 2013. The corresponding adjustments, if any, will be included in the Financial Statements for the year 2015.

The adjustments pertaining to (i) the additional income from IPMO for the year 2014 as a result of the adoption of the straight-line method, (ii) the contingent rent received by the System in January 2015 from PSMT, Inc., (iii) the VAT erroneously imposed on the collection from PSMT, Inc., (iv) the rental income from SUMSI for the month of December 2014 that was received by the System in January 2015 were already adjusted by CD.

Starting 2015, CD will ensure that the contingent rent from PSMT, Inc. will be recognized in the books at every year-end to comply with PAS 17.

The appropriate disclosures relative to the System’s operating leases will be included in the Notes to Financial Statements for the year 2015 after the review of the rental income for the years 2012 and 2013 will be completed.

4.16 By way of rejoinder, notwithstanding the fact that the System already corrected most of the noted errors, the reported rental income for the year ended December 31, 2014 remains materially misstated due to the System’s decision of adopting the straight-line method of recognizing lease income as mandated by PAS 17 in its financial statements only for CYs 2015 and beyond. Further, the disclosures it made relative to its leases do not substantially comply with the information required to be included in the Notes by the same Standard.



## Receivable Accounts

5. The absence of subsidiary ledgers/schedules from which to substantiate eight accounts receivable (AR) amounting to P171.713 million; AR-Non-Trade/Other Accounts totaling to P5.442 million; the discrepancies of P49.455 million between the trial balance and its schedule; and the negative/abnormal balance of P15.491 million in some schedules cast doubt on the reliability and accuracy of the respective accounts as reflected in the financial statements, contrary to pertinent provisions of Presidential Decree (PD) No. 1445. Moreover, a defect in the IFMS Lending Module resulted in erroneous transaction.

5.1 PD No. 1445, otherwise known as the State Audit Code of the Philippines, governs the accounting for and auditing of public funds and properties. The Code requires among others the following:

*“Section 58. Audit of assets. The examination and audit of assets shall be performed with a view to ascertaining their existence, ownership, valuation and encumbrances as well as the propriety of items composing the respective asset accounts, determining their agreement with record, proving the accuracy of such records; ascertaining if the assets were utilized economically, efficiently and effectively; and evaluating the adequacy of controls over the accounts.*

xxx

*Section 111. Keeping of accounts. (1) The accounts of an agency shall be kept in such detail as necessary to meet the needs of the agency and at the same time be adequate to furnish the information needed by fiscal or control agencies of the government.*

xxx

*Section 112. Recording of financial transactions. Each government agency shall record its financial transactions and operations conformably with generally accepted accounting principles and in accordance with pertinent laws and regulations.*

xxx

*Section 114. The general ledger.*

*(1) The government accounting system shall be on a double entry basis with a general ledger in which all financial transactions are recorded.*

*(2) Subsidiary records shall be kept where necessary.”*

5.2 Contrary to the above provisions, the CD did not maintain and did not furnish the SL records/schedules for eight receivable accounts totaling to P171.713 million from which to substantiate existence, reliability, accuracy and completeness as follows:

<b>Accounts</b>	<b>December 31, 2014</b>	
AR Discounted	P	1,010,081
AR Trade, Equities		399,915
AR Trade, Real Estate Buyers		3,595,649
AR Trade, Financing Retention		519,089
AR Others		97,620,128
Advances to Suppliers		282,108
Advances to Contractors		1,754,843
Other Assets		66,530,696
	<b>P</b>	<b>171,712,509</b>

5.3 Verification disclosed that the following accounts showed discrepancies of P49,454,768 between the balance in the trial balance (TB) and the SL schedules:

<b>Accounts</b>	<b>Trial Balance</b>		<b>SL Schedule</b>		<b>Discrepancy</b>
AR Trade, Others – Beg. Investment in Shares of Stocks, net	P	2,746,190	P	2,680,605	P 65,585
ICR		1,652,052,214		1,651,786,993	265,221
ICR, Acquired Assets		374,401,481		369,842,906	4,558,575
ICR, Past Due		4,148,591		9,641,966	5,493,375
Acquired Assets		196,128,908		195,823,941	304,966
		422,724,286		461,491,331	38,767,045
		<b>P2,652,201,670</b>		<b>P2,691,267,742</b>	<b>P 49,454,768</b>

5.4 Moreover, negative balances totaling to P15,491,062 were also noted within the balances of the following receivables:

<b>Accounts</b>	<b>Total Balance</b>		<b>Negative Balances</b>
AR Trade, Lessee	P	3,547,481	299,884
AR Trade, 2nd REM		2,888,575	2,614
AR Trade, Financing Retention		519,089	30,543
AR Non-trade		32,857,606	1,037
Due from JV Office/Partner		809,286	582,559
Installment Contract Receivable (ICR)		374,401,481	9,815
ICR, Past Due		196,128,908	14,564,610
		<b>P 611,152,425</b>	<b>15,491,062</b>

5.5 Three items amounting to P5,442,209 has no available supporting documents and has no subsidiary ledger to substantiate its existence or from which details could be verified are as follows:

<b>Account Code</b>	<b>Schedule</b>	<b>Balance</b>
112101	AR, Non-Trade	P 5,050,410
205101	Past Due-Commercial Loans	40,486
205104	Past Due-Small Business Loans	351,313
		<b>P 5,442,209</b>

5.6 The absence of documents and subsidiary ledgers to keep record of transaction renders unreliable balances of accounts which could either be overstated or understated. Further, while the negative/abnormal items noted in some schedules may not be that material in amount, the nature and existence of these items taint the reliability of the schedules as a whole for it will give a net balance of AR account, which in fact affects only other items in the schedule.

5.7 In addition, the Schedule of Past Due-Car Loans amounting to P1,066,859 includes a particular officer of the System having an outstanding car loan balance of P271,798. The original loan of P783,000, payable for 60 months or five years was granted on December 31, 2005. Verification of the car loan ledger of said employee, however, shows that the loan was already fully paid through salary deductions on December 31, 2010 per OR No. 414580, hence, the inaccuracy and unreliability of the schedule.

5.8 The Controller said that the IFMS-Lending module automatically created an adjusting entry which they could not give explanation as to its reference. The erroneous process may cast doubts on future's transaction using the same module.

5.9 Comparison of different sets of data is aimed at ensuring accuracy and completeness of transactions. It also includes identifying and investigating differences and taking corrective actions when necessary to resolve such differences. Hence, due to non-comparison of data, the discrepancies noted on the foregoing accounts were not detected/determined, thus, the reliability and accuracy of the amounts as reflected in the financial statements are doubtful.

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

- a. Prioritize the preparation of SL/schedules for every account and reconcile the balances to come up with correct and reliable account balances to comply with Section 114 of PD 1445;**
- b. Investigate the causes of the discrepancies between TB and SL schedules and the existence of negative/abnormal items in the schedules including a review and analysis of the validity of the items; and**
- c. For the car loan, review and reconcile the transaction in the IFMS-Lending module to the individual's payroll deductions and make the necessary adjustments;**
- d. Enhance the IFMS-Lending module to produce correct results; and**
- e. Make the necessary adjustments for fair presentation of the accounts in the financial statements.**

5.11 Management commented that the CD is exerting its best effort to reconstruct the Subsidiary Ledgers (SLs) of the receivable accounts. For the year 2014, CD focused on the reconciliation of two major accounts, the Installment Contract Receivable-Current and Past Due and the Buyers' Deposits accounts, since those affects the clients and

have material values. The cleansing of clients records is one of the priority projects in the winding down plans of the System. For said accounts, CD is more than 50 per cent complete of its reconciliation and updating. The schedules and the corresponding subsidiary ledgers that were finished can be made available to the auditors.

It should be noted that the accounts with negative/abnormal balances noted by the COA auditors do not have schedules available even from the time the balances were forwarded to the Integrated Financial Management System 1 (IFMS 1) in 2004. There is difficulty in coming up with the SLs since the same were also not considered in the design of some of the modules in the IFMS. After the crash of the computerized systems in February 2012, records were distorted and manual recording of transactions are being done, thus, resulting in further delay in updating the SLs. CD will exert best efforts to reconcile some, if not all, of the accounts and the corresponding adjustments, if any, will be included in the financial statements for the year 2015. In the absence of the SLs, the transactions affecting the account can be generated from the Legacy System, the IFMS, and the excel-based records. On the enhancement of the IFMS-Lending module, the Management Information System Office (MISO) has already hired a Power Builder Programmer to enhance/improve the IFMS2 application system.

With regard to the fully paid Past Due-Car Loan account, this will be included in the schedule of CD as one of the accounts for reconciliation. The account will be reconciled and the corresponding adjustments, if any, will be included as part of the financial statements for the year 2015.

5.12 By way of rejoinder, the lack or poor maintenance of subsidiary ledgers of an entity makes the reliability of the related accounts highly doubtful. Hence, until the System is able to prepare the related subsidiary ledgers/schedules in good form and free from material errors, the validity of the abovementioned accounts remains doubtful. Moreover, Management's explanation and aggressive efforts to reconcile the receivable accounts and the creation of the SLs and to enhance the IFMS-Lending module through hiring a Power Builder Programmer is duly noted. On the fully paid Past-Due Car Loan account of an active employee of the System, verification of the adjustment with regard to the same will have to be done during the next audit of the System. We further suggest that management create a time table for each activity.

**6. Lack of supporting schedules and various discrepancies totaling to P24.646 million on prepaid expenses account casts doubt on the reliability of the account balances as of December 31, 2014. Moreover, items not currently realizable within the succeeding year were included as part of Prepayments under current assets contrary to Paragraph 57 of PAS 1 – Presentation of Financial Statements.**

6.1 The Philippine Conceptual Framework for Financial Reporting sets out the basic concepts that underlie the preparation and presentation of financial statements for external users. Paragraphs 4.44 and 4.45 thereof provides that:

*“4.44 An asset is recognized in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.*

4.45 *An asset is not recognized in the balance sheet when the expenditure has been incurred for which it is improbable that economic benefits will flow to the entity beyond the current accounting period. xxx”*

6.2 Relative to the presentation of assets in an entity’s financial statements, Paragraph 57 of PAS 1 – Presentation of Financial Statements requires that:

*“57 An asset shall be classified as current when it satisfies any of the following criteria:*

- (a) It is expected to be realized in, or is intended for sale or consumption in the entity’s normal operating cycle;*
- (b) It is held primarily for the purpose of being traded;*
- (c) It is expected to be realized within twelve months after the balance sheet date; or*
- (d) It is cash or a cash equivalent (as defined in IAS 7-Cash Flow Statements) unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the balance sheet date.*

*All other assets shall be classified as non-current.”*

6.3 **Prepaid expenses** are expenditures paid for by an entity in one accounting period but for which the underlying asset will not be consumed by the entity until a future period. These are carried on the balance sheet of an entity as a current asset until it is consumed in accordance with PAS 1. The rationale behind the current asset designation is that most prepaid expenses are consumed within a few months after their initial recognition. If the prepaid expense is not likely to be consumed within the succeeding year, it would instead be classified on the statement of financial position as a non-current asset. Accounting records that do not include adjusting entries to show the expiration or consumption of prepaid expenses overstate assets and net income and understate expenses.

6.4 Owing to the nature of prepaid expenses, sound internal control dictates that detailed schedules indicating information relevant to the proper accounting, disclosure and monitoring of prepaid expenses be maintained and that only those payments expected to be utilized or consumed within a year after the end of the reporting period be reported as prepaid expenses under current assets.

6.5 As at December 31, 2014, the System reported prepaid expenses under current assets amounting to P24,646,487 as follows:

<b>Particulars</b>	<b>Balance</b>
Prepaid tax	P 12,411,875
Prepaid commissions	10,252,981
Prepaid supplies and materials	878,312
Prepaid insurance	518,597
Prepaid subscription/membership	368,360
Prepaid repairs and maintenance	195,606
Prepaid rental	10,756
	<b>P 24,646,487</b>

6.6 Examination of each of the items above disclosed the following:

6.6.1 **Prepaid Tax**

The account is debited for advance payments of real property taxes (RPTs) imposed on the System's various properties. A closer scrutiny of the account revealed that the total amount debited to the account for advance payments of RPTs for CY 2015 does not tally with the account balance at year-end, details follow:

<b>Particulars</b>	<b>Amount</b>
Prepaid tax, per books	P 12,411,875
Advance payment in 2014 of RPT for CY 2015	5,329,066
<b>Unsubstantiated balance</b>	<b>P 7,082,809</b>

Considering that RPTs can only be paid in advance for at most a year, the balance of the account should have equaled the advance payments of RPTs made in 2014 for CY 2015.

6.6.2 **Prepaid Commission**

The CD does not maintain a schedule detailing the prepaid commission outstanding per broker and advances applied as expense during the year. It is the Marketing and Sales Department (MSD) that largely maintains records as to the amount of advance commissions. As of this writing, these records are not consolidated in one schedule.

6.6.3 **Prepaid Supplies and Materials**

The year-end balance does not tie up with the inventory of supplies and materials as of December 31, 2014 of the General Services Department, as follows:

Prepaid supplies and materials, per books	P 878,313
Prepaid supplies and materials, per count	668,086
<b>Unsubstantiated balance</b>	<b>P 210,227</b>

The reported inventory of supplies and materials does not include the cost of unused checks of the System which has an estimated value as at year-end of P60,000. Regardless, a significant discrepancy of more or less P210,000. still exists casting doubt on the reliability of the reported prepaid supplies and materials.

6.6.4 **Prepaid Insurance**

A schedule detailing the amount paid per policy, period covered, monthly write off and prepaid balances, among others, was not provided to support the account balance. Analysis of available data showed that during the current year the following policies were paid:

<b>Policies</b>	<b>Coverage</b>	<b>Premium</b>
Two Toyota Innova 2.0 (TID/278)	12/16/2013 to 12/13/2014	P 15,852
Destruction, Disappearance and Dishonesty Policy	03/18/2014 to 03/18/2015	102,747

<b>Policies</b>	<b>Coverage</b>	<b>Premium</b>
Toyota Avanza (TWI 442/265)	09/01/2014 to 09/01/2015	7,918
Fire, Lightning and Allied Perils	08/15/2014 to 08/15/2015	31,473
RSBS Compound	08/08/2014 to 08/08/2015	262,831
Toyota Avanza (TNQ 590)	11/01/2014 to 11/01/2015	4,248
		<b>P 425,069</b>

All the insurance policies availed by the System covers at most a year. Given this condition, the unamortized premiums of the above policies paid during the year should equal the prepaid insurance balance at year-end. However, this is not the case, as shown below:

<b>Particulars</b>	<b>Amount</b>
Total premiums paid during the year	P 425,069
Less: Amortizations pertaining to the policies	211,596
<b>Unamortized premiums, 12/31/2014</b>	<b>213,473</b>
Prepaid insurance, per books	518,597
<b>Unsubstantiated balance</b>	<b>P 305,124</b>

#### **6.6.5 Prepaid Repairs and Maintenance**

The account is debited for annual payments to two service providers for the maintenance and support services rendered to the System. Records disclosed that the latest payments made to the two providers were effective until February 28, 2014 for the 1<sup>st</sup> provider and October 31, 2015 for the 2<sup>nd</sup> provider.

In view of the above circumstances, the balance of the account at year-end should equal the unamortized portion of the payment made to the 2<sup>nd</sup> provider only. However, analysis of the account showed a discrepancy as follows:

<b>Particulars</b>	<b>Amount</b>
Amount paid to 2 <sup>nd</sup> provider for license and maintenance support of the Fortigate firewall and Fortinet analyzer from 11/01/2014 to 10/31/2015	P 146,025
Less: Amortization from 11/01/2014 to 12/31/2014	24,338
<b>Unamortized balance, 12/31/2014</b>	<b>121,687</b>
Prepaid repairs and maintenance, per books	195,606
<b>Difference</b>	<b>P 73,919</b>

Result of the investigation to reconcile the resulting difference above disclosed the following:

<b>Particulars</b>	<b>Amount</b>
Under amortization for CY 2014	P 11,063
Under amortization for CY 2013	26,205
<b>Total</b>	<b>37,268</b>
Difference to be accounted for	73,919
<b>Unsubstantiated balance</b>	<b>P 36,651</b>

#### 6.6.6 *Prepaid Rental*

The prepaid rental pertains to the security deposit paid to a lessor in 2010 and 2011 for the lease of its property in Iloilo City. The deposit remains uncollected even after the end and subsequent renewal of the lease term in 2012 and 2013.

6.7 The combined effect of the discrepancies and deficiencies noted above cast doubt on the reliability of the total reported prepayments of the System as at year-end and therefore do not conform to the category of an asset as prescribed by the standard aforementioned, thus, account balance is misstated.

#### 6.8 **We recommended that Management:**

- a. **Submit all documents to prove the reliability of the transactions;**
- b. **Investigate and reconcile the noted unsubstantiated balances in each item of the prepaid expenses and adjust the accounts, as necessary;**
- c. **Require the concerned operating departments to properly monitor the System's prepaid expenses through, but not limited to, the preparation of detailed supporting schedules, otherwise, the same should not be recorded in the books under the prepaid accounts; Prepare adjusting entries to correct the errors in amortizing prepaid expenses; and**
- d. **Present the portions of the prepaid expenses not likely to be consumed or realized within the succeeding year as non-current assets to comply with the requirements of PAS 1.**

6.9 Management commented that the variances noted by the COA are mostly attributable to the beginning balances of the accounts that were forwarded to the IFMS1 in 2004. The reconciliations for said accounts were delayed since priorities were given to the Cash and Receivable accounts. CD will exert best efforts to reconcile the accounts and make the necessary adjustments in the Financial Statements for the year 2015.

#### Prepaid Commission

With regard to Prepaid Commission, the Marketing and Sales Department has already prepared the Summary of the Total Commission Due and Released pertaining to the sales for 2014. Despite the absence of the consolidated schedule for the prepaid commission account, CD can assure and will always ensure that no overpayments shall be released to the brokers or marketing agents.

6.10 As a rejoinder, although the System was able to adjust and corroborate its prepaid materials balance, a larger portion of its total prepaid expenses remains unsubstantiated. Hence, the reliability and validity of the reported total prepaid expenses are still doubtful. Further, while we do not pre-empt the reconciliation to be conducted by the CD, it is notable that as the observed variances were mostly ascribed to items prior to 2004 the unsubstantiated balance would have been utilized or consumed already by the System. Prepaid expenses, by their nature, are utilized or consumed by an entity in one year. Moreover, the presentation of these balances as



part of the System's current assets is inappropriate regardless of the outcome of the promised reconciliation.

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

7.1 Pursuant to Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001, and the Implementing Rules and Regulations issued pursuant to that Act, the Energy Regulatory Commission (ERC) promulgated on January 18, 2006 the Distribution Services and Open Access Rules (DSOAR) that set forth among others the terms and conditions related to the provision of connection assets and services.

7.2 Sections 2.6.1 and 2.6.2 of the DSOAR on Modifications and New Physical Connections provides that:

***“2.6.1 RIGHT TO EXTENSION OF LINES AND FACILITIES***

*In accordance with the Magna Carta, a residential end-user located within thirty (30) meters from the distribution utilities' existing secondary low voltage lines has the right to an extension of lines or installation of additional facilities, other than a service drop, at the expense of the utility. However, if a prospective customer is beyond the said distance, the customer shall advance the amounts necessary to cover the expenditures on the facilities beyond thirty (30) meters.*

**2.6.2 REFUND**

*To recover the aforementioned advanced payment, the customer may either demand the issuance of a notes payable from the distribution utility or a refund at the rate of twenty-five (25) percent of the gross distribution revenue derived from all customers connected to the line extension for the calendar year until such amounts are fully refunded or for five (5) years whichever period is shorter, or, if available, the purchase of preferred shares. xxx” (Emphasis supplied)*

7.3 In view of new regulatory frameworks, the ERC adopted on February 13, 2012, Resolution No. 3, series of 2012 amending some portions of the DSOAR including Sections 2.6.1, now numbered as 2.6.2. The revised section of the DSOAR now states that:

***“2.6.2 RIGHT TO EXTENSION OF LINES AND FACILITIES***

*Provided that the project is viable, a residential end-user has a right to an extension of lines or installation of additional facilities at the expense of the distribution unit.*

*A project shall be considered as viable if the cost of installing lines and facilities is at least equal to the revenue/s derived from customer/s connected thereto within the standard asset life of such lines and facilities as determined under existing ERC rules and regulations.*

*If the project is not viable as referred to above, the customer or developer may advance the amounts necessary to cover the expenditures on the non-standard connection assets/facilities. xxx*" (Emphasis supplied)

7.4 Being engaged in real estate projects, the System's responsibility is to ensure that its residential subdivisions have adequate electric service. In fulfilling such duty, the System made several applications for service connection with MERALCO from 2006 to 2014 requiring deposits/advances to MERALCO pursuant to the DSOAR, details follow:

<b>Various Dates</b>	<b>Project</b>	<b>Amount</b>
2006-2014	Riviera Residential Estate	11,025,788
2006-2013	Villa Segovia	1,585,360
2006-2008	Villa de Toledo	246,170
		<b>12,857,318</b>

7.5 The agreements relating to the above extension of lines and/or installation of additional facilities provided for an annual refund to the System of 25 per cent (or 75 per cent for some projects) of the gross distribution revenue realized from all customers directly connected to the lines/poles/facilities for the calendar year, commencing from the energization of service, until the amount advanced has been fully refunded. Moreover, the agreements granted MERALCO the right to offset the amount for refund or the balance thereof against unpaid electric bills which are already due and demandable.

7.6 Records showed that as of December 31, 2014, no credits were made against the cash advances to MERALCO since 2006 suggesting that there were neither refunds received nor offset of any due and demandable unpaid electric bills against the amount for refund contrary to the agreements signed.

7.7 Verification in the IFMS through the CD revealed that there were indeed no refunds received from MERALCO for the deposits/advances made by the System. However, it cannot be determined with certainty if there were no offset of due and demandable unpaid electric bills against the advances though, as observed, billings from MERALCO do not indicate therein any offsets.

7.8 Meanwhile, per inquiry with the Property Management and Enhancement Department (PMED), some applications for service connections in 2014 for the Riviera Residential Estates were not yet or were just acted upon. Thus, the System is not entitled for any refunds yet relating to these applications as of year-end.

7.9 The non-refund to the System of the advances on a timely basis does not only deprive the System of funds available for use in operations but also deny it the opportunity to earn income and contribute to the growth of the System's equity. Moreover, possible offsets made by MERALCO unknown to the System overstate the reported receivables.

**7.10 We recommended that Management:**

**a. Retrieve/produce all documents relative to the deposits made including proof of accomplishments then make personal representation with MERALCO for the following:**

- 1. The status of each service connection projects completed to determine the propriety of a refund;**
- 2. Any offsets made to be able to update the accounts of the System.**

**b. Demand payment of refunds for those the System is entitled to and update the accounts for any offsets made; and**

**c. Properly monitor the status of subsequent cash advances for service connection applications including but not limited to annual communication with MERALCO.**

7.11 Management commented that the PMED has already retrieved the documents and identified the status of each of the deposits paid to MERALCO for the installation of electrical facilities for various subdivision projects of the System. The department has likewise received notice of refund from MERALCO and is presently in the process of filing application for the respective refunds. For deposits without notice of refund, PMED shall make verification from MERALCO. For subsequent deposits for service connection applications, the System will ensure that the same will be properly monitored.

**8. The System's recording of real estate sales from 2012 and prior years to 2014 when full down payment are received from one of its agents/brokers rather than when said agent/broker receives payment from the buyers resulted in the delay in recording of transactions, which understated the reported/recorded Income/Retained Earnings for CY 2013 and prior years by P2.449 million and understated the reported net income for CY 2014 and possibly for CY 2015 by P1.162 million and P1.940 million, respectively. The reported balances of Receivable and Payable accounts as of December 31, 2014 are also understated by P5.462 million and P1.765 million, respectively. Penalties provided for under the Marketing Agreement were not imposed on delayed remittance of collections.**

8.1 As part of the System's strategies to maximize earnings, the System entered into agreements with several parties to sell the System's properties on its behalf. RSBS entered into a Marketing Agreement dated September 24, 2013 with a Marketing Manager for the Green Meadows project in Iloilo. Significant provisions of said Agreement follow:

***"2.1 Marketing Manager shall actively promote and market and facilitate the sales and documentation of LANDOWNER's and DEVELOPER's lots identified in SHARING OF LOTS.***

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**2.3 Marketing Manager shall collect and receive from its buyers on behalf and as trustee of Landowner and Developer, the reservation fees and down payments for the lots it sells, and shall issue provisional receipts therefore. All payments covering the reservation fee and down payment shall be payable to the Marketing Manager, which payments shall be collected and held in trust by Marketing Manager for an in behalf of Landowner and Developer. Subsequent amortization payments shall be made payable to and collected and received by Landowner or Developer as the case may be. Penalties that may be imposed by the Marketing Manager as compensation for ensuring one hundred percent (100%) collection of down payments. Any and all options/reservation fees and other charges and penalties that may be forfeited due to the cancellation of reservation of reservation agreement and/or contracts executed with the buyer shall accrue to the Landowner and Developer to whom the lots are assigned.**

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**2.4 Marketing Manager shall remit to Landowner and Developer all reservation fees and down payments collected and received for the week, less the Marketing Management fee as provided in Section 3 of this Agreement, within twelve (12) working days from date of issuance of Provisional Receipt. In the event that the Marketing Manager refuses or fails to remit said collections or any part thereof, within the specified period, it shall pay the Landowner and/or Developer interest on the unremitted portion at a rate of 24% per annum until fully remitted without prejudice to the rights of the Landowner and/or Developer to terminate this Agreement with sixty (60) days written notice to the Marketing Manager and exercise other legal remedies.” (Underscoring supplied)**

8.2 Review of the sales reports of the Marketing and Sales Department (MSD) and of the CD for CY 2014 revealed that a number of sales transactions were improperly recorded which over/understate income, receivable, discounts, investment in real estate and payables from real estate operations, thus, casts doubt on the fair presentation of the financial statement of the System, details follow:

Particulars	2012 and prior years	2013	2014	2015
<b>Revenue/Sales</b>				
a. 2013 sales remitted and recorded in 2014		2,680,500	(2,680,500)	
2014 sales remitted and recorded in 2015			5,394,000	(5,394,000)
b. Unrecorded current year's sales			5,462,327	
c. Prior year sale recorded as cost of sales	1,488,000			
Prior years sale recorded as current year sale	5,213,200		(5,213,200)	
<b>Under-(over-)statement of revenues</b>	<b>6,701,200</b>	<b>2,680,500</b>	<b>2,962,627</b>	<b>(5,394,000)</b>
<b>Discounts</b>				
a. 2013 Discounts remitted and recorded in 2014		60,340	(60,340)	
a. 2014 Discounts remitted and recorded in 2015			415,296	(415,296)

Particulars	2012 and prior years	2013	2014	2015
b. Unrecorded current year's discounts			973,949	
c. 2012 and below	102,400		(102,400)	
e. Other errors and discrepancies			243,000	
<b>Under-(over-)statement of discounts</b>	<b>102,400</b>	<b>60,340</b>	<b>1,469,505</b>	<b>(415,296)</b>
<b>Broker's Commission (BC)</b>				
a. 2013 sales remitted and recorded in 2014		440,187	(440,187)	
a. 2014 sales remitted and recorded in 2015			836,422	(836,422)
B. Unrecorded BC on current year's sales			493,619	
c. Prior years BC recorded as current year sale	951,181		(951,181)	
<b>Under-(over-)statement of discounts</b>	<b>951,181</b>	<b>440,187</b>	<b>(61,327)</b>	<b>(836,422)</b>
<b>Cost of RE Properties</b>				
a. 2013 Cost of RE Properties paid and recorded in 2014		218,631	(218,631)	
a. 2014 Cost of RE Properties paid and recorded in 2015			2,202,557	(2,202,557)
b. Unrecorded current year's Cost of RE Properties			1,765,356	
c. Prior years cost of sale recorded as current year sale	3,671,617		(3,671,617)	
e. Other errors and discrepancies			314,300	
e. Selling prices relative to prior year sale inadvertently credited to cost of sales	1,488,000			
<b>Under-(over-)statement of cost of RE</b>	<b>3,671,617</b>	<b>218,631</b>	<b>391,965</b>	<b>(2,202,557)</b>
<b>Net Effect on Retained Earnings/Net Income</b>	<b>488,002</b>	<b>1,961,342</b>	<b>1,162,484</b>	<b>(1,939,725)</b>

### **Effect on Real Accounts**

	Amount
<b>Installment Contracts Receivable</b>	
a. 2014 sales remitted and recorded in 2015	5,394,000
a. 2014 Discounts remitted and recorded in 2015	(415,296)
b. Unrecorded current year's sales	5,462,327
b. Unrecorded current year's discounts	(973,949)
e. Other errors and discrepancies	(243,000)
<b>Under-(over-)statement of ICR</b>	<b>9,224,082</b>
<b>Investment in Real Estate</b>	
a. 2014 Cost of RE Properties paid and recorded in 2015	(2,202,557)
b. Unrecorded current year's Cost of RE Properties	(1,765,356)
e. Selling prices relative to prior year sale inadvertently credited to cost of sales	(1,488,000)
<b>Under-(over-)statement of ICR</b>	<b>(5,455,913)</b>
<b>Due to Parent</b>	
e. Other errors and discrepancies	(243,000)
<b>Under-(over-)statement of Due to Parent</b>	<b>(243,000)</b>
<b>Payable to Broker</b>	
a. 2014 sales remitted and recorded in 2015	836,422
b. Unrecorded current year's commission	493,619
<b>Under-(over-)statement of Payable to Broker</b>	<b>1,330,041</b>
<b>Retained earnings</b>	
a. 2014 sales remitted and recorded in 2015	5,394,000
a. 2014 Discounts remitted and recorded in 2015	(415,296)

	<b>Amount</b>
b. Unrecorded current year's sales	5,462,327
b. Unrecorded current year's discounts	(973,949)
a. 2014 sales remitted and recorded in 2015	(836,422)
b. Unrecorded current year's commission	(493,619)
a. 2014 Cost of RE Properties paid and recorded in 2015	(2,202,557)
b. Unrecorded current year's cost of RE properties	(1,765,356)
e. Selling prices relative to prior year sale inadvertently credited to cost of sales	(1,488,000)
<b>Under-(over-)statement of Retained Earnings</b>	<b>2,681,128</b>

**a. 2013 sales/discounts/brokers commission remitted in 2014 and 2014 sales/discounts/commission remitted in 2015**

Sales/discounts from the sale of Green Meadows properties amounting to P2,680,500/P60,340/440,187 and P5,394,000/P415,296/(836,422) in 2013 and 2014, respectively were recorded in 2014 and 2015 on the dates remittances were made by the Marketing Manager and not when the full down payment has been received contrary to No. 2.4 of the Marketing Agreement.

Considering that under the law an agent is an extension of the personality of the principal, payment from the buyer is essentially received by the System when such payment is received by the Marketing Manager. Hence, the criterion as to the collectability of the sales price has already been met when Marketing Manager receives the payment from the buyer. Recognition of sales is therefore proper even when the payment is not yet remitted to the System.

Important to ensuring the timely recording of sales to reflect the above principles is the stringent observance by Marketing Manager of the contractually agreed remittance period. As observed, more often than not the Marketing Manager fails to remit payments from buyers within the 12 working day period set in the Marketing Agreement.

The System is also to be faulted for the continuous failures by Marketing Manager to remit as follows:

- It failed to strictly monitor the compliance by Marketing Manager with the provisions in the Marketing Agreement as to its responsibilities; and
- It failed to impose the penalty by way of an interest of 24 per cent per annum on the unremitted portion of collections from buyers.

**b. Unrecorded current year's sales/discounts/brokers commission**

The real estate sales/discounts of the current year amounting to P5,462,327/(P973,949)/(P493,619) have been mistakenly excluded but should have been recognized as sales this year as the buyers were able to pay the required down payment during the year:

**c. Prior years' sales recorded as current years' sales/discounts/brokers commission**

The real estate sales/discounts earned in the prior year amounting to P5,213,200/P102,400/P951,181, were improperly recorded as sales for the current year following the full accrual method adopted by the System :

Meanwhile, a sale of property for P585,000 in January 2011 remained unrecorded as of December 31, 2014. While this sale does not affect current year's net income, the CY 2011 net income and beginning unappropriated retained earnings are understated.

***d. Non-charging of cost of sales***

No costs of sales were charged to the sale to Buyer Y. Per verification with the CD, the book value of the property sold is already nil because the same was already charged as cost of sales in prior years. This was the result of the inaccurate number of units used in computing the cost per square meter of lot that is used in costing inventories.

Evidently, the non-charging of cost against revenue is improper. As the deficiency results from an error, the previously recognized cost should be adjusted through the retained earnings and charged as cost of sales this year to properly match expense with the related revenue.

***e. Other errors and discrepancies***

The following errors and discrepancies were also noted from our review of the real estate sales of the System:

- The discount of P270,000 granted for the sale to Buyer Z was recorded as P27,000. The difference of P243,000 was erroneously debited to Due to Parent. This error overstated the income from real estate operations by P243,000 and overstated the total liabilities by the same amount.
- The selling prices totaling P1,488,000 relative to the prior year sale to Buyer AA and AB were inadvertently credited to cost of sales thereby understating sales revenue by P1,488,000 and understating cost of sales by the same amount.
- The sale to one Buyer remains unrecorded pending resolution of problems with regards to his payments which are yet to be accounted for completeness. It cannot be ascertained prior to such reconciliation if revenue recognition is proper. This uncertainty may potentially understate sales revenue, broker's commission and cost of sales by P845,000, P141,960 and 298,262.90, respectively.

8.3 To summarize, as shown in the table in Paragraph 8.2 above, the System's recording of real estate sales from 2012 and prior years to 2014 when full down payment are received from one of its agents/brokers rather than when said agent/broker receives payment from the buyers resulted in the delay in recording of transactions, which, along with other noted errors, understated the net income for CY 2014 and CY

2013 and prior years by P1.162 million and P2.449 million, respectively; and possibly understated the CY 2015 net income by P1.940 million. The reported balances of Installment Contracts Receivable, Payable to Broker and Retained Earnings as of December 31, 2014 are also understated by P9.224 million, P1.330 million and P2.681 million, respectively while the reported balances of the Investment in Real Estate and Due to Parent are overstated by P5.456 million and 0.243 million, respectively. Further, penalties provided for under the Marketing Agreement were not imposed on delayed remittance of collections.

8.4 Meanwhile, two important controls to lessen errors in recording and reporting sales transactions are missing. No sales cut-off tests were performed after every year-end by the CD. It simply recognized some sales in the period it gets to know of such sale and disregarding the correct period it is earned and should be recorded. No reconciliation of the sales reported by the MSD and that recorded by the CD is made from which discrepancies could have been avoided. Current practice showed that the CD and MSD lack coordination in reporting sales. While the MSD prepares a sales report monthly which it forwards to the CD for recording, there generally was no follow ups to check if all the reported sales were promptly recorded by the CD and if not, reasons for the non-recording thereof. The CD, on the other hand, at times fails to inform and explain to the MSD if some of their reported sales were not recorded for a justifiable reason. Hence, the discrepancies.

**8.5 We recommended that Management:**

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

- **Recognizing real estate sales when payments are received by Marketing Manager and other agents/brokers regardless of remittance of the same to the System;**
- **Enforcing compliance by Marketing Manager and other agents/brokers to timely report sales for proper recording and remit payments from buyers within the period specified in the Marketing Agreement including contractually agreed penalties on late remittances; and**
- **Performing sales cut-off tests and monthly reconciliations of sales summaries and records to discover any error committed.**

**b. Prepare adjusting journal entries to correct the affected accounts; and**

**c. Promptly resolve the issue relative to the sale to one buyer and recognize the same as sale for the current year if appropriate.**



8.6 Managements commented as follows:

**On the recognition of sales**

For years, it has been the System's practice to record the sale of lots for projects under the Joint Ventures (JV) upon the receipt of remittances for full downpayments from our JV Partners and Marketing Agents. Prospectively, the System will record the sales upon receipt by the JV partner/collection agent of the full downpayment. Coordination will be made with the JV partner/collection agent to ensure that the System receives the required reports as needed.

For the year 2015, CD has already devised a monitoring system for the recording of sales. As an added measure, on a monthly basis, CD will provide the Marketing & Sales Department (MSD) with a copy of the recorded sales per month for them to reconcile with their records. Sales cut-off tests will also be undertaken to ensure that all valid sales during the year will be recorded and accounted for in the proper accounting period.

**On the Compliance of Marketing Manager and Other Agents/Brokers**

In line with the winding down status of RSBS, the System is constantly monitoring the compliance of all our Joint Venture Partners to include Marketing Manager. Moreover, to ensure the proper disposal of the remaining properties/inventories, the management formed various committees who were tasked to handle the divestment of its assets.

**On the accounts with errors and discrepancies**

On the various accounts with errors and discrepancies that were noted by the COA auditors, the corresponding adjustments were already made by CD

The sale pertaining to the lot/property was already recorded per RSBS JV No. RE-0040-ADJ1-14. The issue on the payments for the account of another buyer is still being reconciled by CD and MSD. The corresponding adjustments, if any, will be made in the financial statement for the year 2015 once the account will be reconciled.

8.7 As a rejoinder, as the System will prospectively apply the recommended timing of recognizing real estate sales, the reported income from real estate operations of the System for the year ended December 31, 2014 remains misstated. This will also be true with the income from real estate operations for the succeeding period as sales supposedly for 2014 were recorded in 2015.

Further, we take exception to Management's comment that it constantly monitors the compliance of all its JV partners including Marketing Manager with their respective agreements. As previously mentioned, Marketing Manager often remits to the System the payments of the buyers beyond the period agreed in the Marketing Agreement and without being penalized for doing so. This condition is prejudicial to the System.

**9. Ten properties were sold at a total loss of P1.281 million without the required appraisal and public bidding prior to sale contrary to the System's Standard Operating Procedure (SOP) No. 01-13 dated June 27, 2013**

9.1 Section V A-1 and 2 of SOP No. 01-13 provides that;

“Sales terms and conditions, including the floor price of each property to be bid out shall be approved by the Board of Trustees.

The FMV of the property on an as-is, where-is basis shall dictate the floor price of the property. As such, a recent independent appraisal (within 12 months from bid date) shall be required for all properties that shall undergo public bidding.”

9.2 Sales from Real Estate properties by the System at a loss amounting to P1,281,103 were due to the following factors:

a. The failure of the CD to timely update its cost per unit of inventory schedule and inform the Marketing and Sales Department (MSD) of factors affecting the same. Per verification, the cost schedule is not updated annually. The schedule used was as of July 2014 and prior to that the latest updates were in 2012 and 2010. Considering that the MSD takes into account the actual costs in pricing inventories, the reliability of the cost schedule cannot be overemphasized.

b. The non-appraisal by the System of its investment in real estate regularly (raised in prior year's AOMs). Aside from the fact that the appraisal of properties is mandated by Philippine Accounting Standards (PAS) 36 – Impairment of Assets for valuation purposes, the appraised value of the properties can serve as a guide in assessing the reasonableness and adequacy of established selling prices.

9.3 It is fundamental in sale transactions that selling prices be set enough to (a) recover the cost of the item sold plus costs incidental to the holding and sale thereof; and (b) to provide a reasonable profit to the seller which should be greater than the potential income from the next best use of the peso investment employed.

9.4 While the effort of the management to resolve the issue at hand prior to the audit is commendable, there should have been control activities already in place that should have prevented the sale of the properties at a low price. Setting the price of a property is not a quick process. Upon the buyer's expression of interest to buy the property, the System has a lot of time to study and analyze the cost-benefit expected from the potential sale.

9.5 Contrary to its mandated purpose, the System sold 10 properties at a loss. (Annex C) This amount does not take into account yet the income/opportunity foregone if the peso investment tied up with the properties that remained unsold for significant period of time were rather used in a more profitable venture.

9.6 It has to be borne in mind that the System is a government entity and its funds, which came from the National Government and the AFP military personnel, are public in

nature. Accordingly, exercise of due diligence is expected in the pursuit of its mandated functions, as well as by its officers and employees in the performance of their duties and responsibilities.

**9.7 We recommended that Management:**

- a. Install controls to prevent selling of properties at a loss, i.e. regular appraisal of properties and MSD verifying if the cost data used for pricing is correct/updated; or review and improve, if necessary the controls currently in place;**
- b. Study if revision of selling prices of other properties is feasible taking into account the properties' latest appraised values and current market conditions among others; and**
- c. Require the review and regular updating at least annually of the schedule of cost to be applied for each item of inventory.**

9.8 Management commented that the two lots singled out that were allegedly sold at a loss in 2014 were actually sales consummated much earlier but were only recorded in 2014. The lot sold to Buyer 5 had a value date of 07 September 2010 while that sold to Buyer 4 had a value date of 16 August 2013. When the current management took over, sale of one project was put on hold due to the losses being incurred.

Management is likewise aware of the fact that the inventory cannot compete with similarly situated developments if the price is increased now to levels that would bring in significant income for the System. Latest appraisal reports have not shown a great appreciation in the market value of the land in the area to be able to merit a major price increase, especially since our JV partner can afford to sell at current pricing. As it is, hedging may be resorted to and the System can capitalize on selling in the future when the inventory of our partner is depleted and ours can fetch higher pricing.

In the meantime, Management is also looking at novel ways of disposing its inventory thru selling the lot as a house and lot package or in another tie-up with a reputable partner. Until then, it is more prudent on the part of the System to just hold the sale of all its inventory in this project.

The cost of sale of the sports and country club shares is P96,128 instead of P53,796 as indicated in the schedule provided by CD. Using the correct figure, the transaction resulted in income for the System.

As to the golf shares, when MSD documents the sale of a fairway lot, it prepares three Deeds of Sale – one for the lot, one for the golf club share and one for the country club share. This is done even when our pricing is inclusive of these shares. Hence, the purchase price is divided to accommodate the pricing of the shares which is P350,000 for the golf share and the P90,000 for the CC share, the remainder is being allocated to the lot price. Though the cost of sale for the golf club shares is P300,900.69, the discounts given to cash buyers will result in a “loss” for recording the sale of that share alone. However, if the package is taken as a whole, the transaction will result in pure income.

For the lot sold to Buyer 3, the cost of sale per audit is P277,350. However, per MSD records, the cost of sale should only be P212,447 or P2,971.29/sqm as per our reference from CD – Investment in Real Estate Project Inventory as of 31 July 2014.

MSD would like also to mention that the inventory of one subdivision is not subject to SOP No. MSD 01-13. All inventories that revert back to MSD are “cancelled” sales and not foreclosed properties. MSD only requires appraisal for these cancelled sales if there is a house unit involved to be able to determine the current value of the improvement of the lot. If there is no improvement, all properties that stem from the cancelled transactions are automatically priced based on the prevailing selling price set by MSD.

Please note that the first revision in selling prices was made as early as 26 November 2012. Another price increase was implemented on 01 November 2014. The first price increase already had the residential lots selling at an income. As to the sale in question, the reservation was approved on 19 October 2012 by the previous MSD head when the original selling prices still prevailed. Value date of the said transaction was moved to 20 January 2014 due to client’s approved request for an extension to complete the down payment.

The latest appraisal for this property was dated 17 June 2014 and it revealed that market value for our remaining lots was P225.00/sqm, which is still much lower than our book value of P270.00/sqm. As such, MSD deemed it more sensible to just stop selling the lots until market forces dictate that a higher price can be offered. Early this year, Management, directed MSD to resume selling the lots at a level that would result in income for the System, hence a gross price of P500.00/sqm.

CD has already updated the schedule of cost as of 31 December 2014. CD will ensure that the updating of the said schedule will be done annually or as necessary to aide in the decision making of the management.

9.9 By way of rejoinder, the reasons forwarded by Management is duly noted, however, we wish to emphasize the importance of updating regularly the schedule used for costing purposes and the importance of accuracy. Furthermore, we wish to emphasize that all data pertaining to the subject sales came from the CD.

**10. The Stock investment account totaling P31.354 million as at December 31, 2014 is overstated by P0.732 million due to the failure to deduct the correct carrying value of the sold shares of stocks. Also, the classification of the investment as current asset as well as the recognition of its income is contrary to Paragraph 9 of PAS 39 on Financial Instrument: Recognition and Measurement. Moreover, unrealized gain on changes of fair value during the year amounting to P11.278 million was recognized as income through profit/loss and cumulative unrealized gain and loss of P10.936 million and P4.136 million, respectively, were not presented as part of the equity due to System’s treatment as financial asset through profit/loss contrary to Paragraph 55 of the same standard.**

10.1 PAS 39, paragraph 9 states that:

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*A financial asset or financial liability at fair value through profit or loss is a financial asset or liability that meets either of the following conditions.*

*(a) It is classified as held for trading. A financial asset or liability is classified as held for trading if it is:*

*(i) acquired or incurred principally for the purpose of selling or repurchasing it in near term;*

*(ii) part of a portfolio of identified financial instruments that are managed together and for which there are evidence of a recent actual pattern of short-term profit-taking;*

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*Available-for-sale financial asset are those non-derivative assets that are designated as available for sale or are not classified as (a) loans and receivable, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.*

10.2 Paragraph 55 of the same PAS provides that:

*A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship shall be recognized, as follows.*

*(a) A gain or loss on financial asset or financial liability classified as at fair value through profit or loss shall be recognized in profit or loss.*

*(b) A gain or loss on an available-for-sale financial asset shall be recognized directly in equity, through the statement of changes in equity at which time the cumulative gain or loss previously recognized in equity shall be recognized in profit or loss.*

10.3 Stock investment is classified as short-term investment and treated as financial asset through profit or loss as evidenced by the recognition of gain or loss arising from changes in the fair value of the financial asset in the profit or loss by using the Recovery from Decline in Market Value (DMV) of Stocks and Provision for Decline in Value of Short-term Investments accounts. Recovery from DMV and Provision for Decline in Value totaling P15,322,773 and P4,236,066, respectively, were recognized during the year.

10.4 On March 24, 2014 shares of stock in International Container Terminal Services (ICT) and Top Frontier Investment Holdings, Inc. (TFHI) were sold by the System. However, the recorded sales transaction resulted in an overstatement in Stock Investment account by P731,580 arrived at as follows:

<b>Particulars</b>	<b>ICT</b>	<b>TFHI</b>	<b>Total</b>
Acquisition Cost	P1,973,800	P 712,000	P 2,685,800
Add/(Less) :Unrealized Gain/(Loss)	779,580	(48,000)	731,580
Carrying Value	2,753,380	664,000	3,417,380
Deducted Carrying Value	1,973,800	712,000	1,973,800
<b>Carrying value not deducted</b>	<b>P 779,580</b>	<b>P (48,000)</b>	<b>P 731,580</b>

10.5 The above shares of stock in ICT and TFHI were sold for P2,917,814 and P338,926, respectively. A realized gain on sale of P570,939 were recorded with the entries as follows:

<b>Particulars</b>	<b>ICT</b>	<b>TFHI</b>	<b>TOTAL</b>
Selling Price	P 2,917,814	P 338,926	P 3,256,739
Deducted Carrying Value	1,973,800	712,000	2,685,800
<b>Recorded Gain on Sale</b>	<b>P 944,014</b>	<b>P (373,074)</b>	<b>P 570,939</b>

Cash	3,256,739	
Money Market Placements		2,685,800
Gain/Loss on Sale of Stocks		570,939

10.6 However, based from data gathered, the realized gain/(loss) that should have been recognized should be P3,417,380.00 and should have been recorded with the entries as follows:

Cash	3,256,739	
Retained Earnings	731,580	
Money Market Placements		3,417,380
Gain/Loss on Sale of Stocks		570,939

10.7 The System does not have the Cumulative unrealized gain/loss – Available for Sale account or other account as its equivalent to record the changes in fair value of its stock investment since it is not adopting the accounting for financial asset through other comprehensive income for its stock investment.

#### ***Stock investment as Available-For-Sale***

10.8 Review of the System's accounting policy on Stock Investment disclosed that it adopts the treatment of financial asset through profit or loss (trading securities) contrary to Par. 9 of PAS 39. As a result of this, the System failed to recognize the unrealized gain of P11,278,137 as part of other comprehensive income, as shown below:

<b>Name of Corporation</b>	<b>Fair Value</b>		<b>Unrealized Gain/(Loss)</b>
	<b>12/31/2013</b>	<b>12/31/2014</b>	
PSE	P 7,200,000	P 8,576,640	P 1,376,640
SMC	2,500,000	2,952,000	452,000
LR	2,995,334	5,794,272	2,798,938
EDC	5,330,000	8,200,000	2,870,000

Name of Corporation	Fair Value		Unrealized Gain/(Loss)
	12/31/2013	12/31/2014	
ION	43,800	74,400	30,600
MPI	2,151	2,291	139
PLC	542,700	4,281,300	3,738,600
MAH A	3,500	3,500	0
PTT	672,094	672,094	0
V	54,340	65,560	11,220.00
	<b>P 19,343,919</b>	<b>P 30,622,057</b>	<b>P 11,278,137</b>

10.9 Also, the cumulative unrealized gain and loss of P10,936,853 and (P4,136,893), respectively, was not presented as part of equity since the System classified it as financial asset through profit or loss. However, one of the stock investment has no acquisition value to compute its cumulative unrealized gain/(loss) as shown below:

Name of Corp	Acquisition Value	Fair Value 12/31/2014	Unrealized	
			Gain	(Loss)
PSE	P 1,664,151	P 8,576,640	P 6,912,489	
MC	4,610,939	2,952,000		P (1,658,939)
LR	3,752,828	5,794,272	2,041,444	
EDC	6,217,980	8,200,000	1,982,020	
ION	805,672	74,400		(731,271)
MPI	13,566	2,2901		(11,275)
PLC	6,016,707	4,281,300		(1,735,407)
MAH A	2,600	3,500	900.00	
PTT	672,094	672,094	-	
V		65,560		
	<b>P 23,756,536</b>	<b>P 30,622,057</b>	<b>P 10,936,853</b>	<b>P (4,136,892)</b>

10.10 **We recommended that Management:**

- a. **Prepare the adjusting entries to correct the Stock investment account and Retained Earnings by P731,580;**
- b. **Treat its stock investment as Available-For-Sale financial asset and adopt the accounting policy for it; and**
- c. **Accordingly, adjust the following subsidiary ledger balances-Recovery from DMV of stocks totaling P15,322,773 and Provision for decline in market value of short-term investment totaling P4,236,066 as part of the profit/loss and instead recognize an unrealized gain/(loss) of P11,278,137 in other comprehensive income portion of Comprehensive Income for the remaining stock investment.**

10.11 Management commented that Stock investment are treated as financial assets since the purpose of acquiring said stocks are for trading purposes, .i.e. buying and selling of the same for the purpose of earning profit. For CY 2014, the System projected some trading gains and losses which showed the said intention. During the year, some

shares were actually sold. Other shares were not sold since the target selling prices are not yet reached.

10.12 By way of rejoinder, our evaluation shows that stock investments are not actually financial assets held for trading but financial asset-available for sale. Therefore, the changes in fair value should be treated as part of Other Comprehensive Income instead of Recovery from DMV of stocks/Provision for decline in market value of short-term investment which is contrary to PAS 39, Paragraph 9.

**11. Negotiated procurement of the IFMS Platform Migration Database Infrastructure Upgrade amounting to P3.197 million was recorded as Office Machineries and Equipment instead of Intangible Assets contrary to Paragraph 8 of PAS 38. Likewise, the system is depreciating the asset instead of amortizing the intangible assets.**

11.1 Paragraph 8 of PAS 38 defines Intangible Assets as an identifiable non-monetary asset without physical substance, whereas, amortization is the systematic allocation of the depreciable amount of an intangible assets over its useful life.

11.2 During the year, the System entered into a negotiated consultancy services contract with Contractor A for the development/upgrade of its systems applications and database in the amount of P3,197,370, which can be considered an intangible asset under Paragraph 8, PAS 38. Based on documents gathered (RVCP and check vouchers) the said amount was recorded under Office Machineries and Equipment instead of intangible assets contrary to the above provision of PAS 38. We also noted that the system has no account to record the intangible assets.

11.3 Furthermore, the General Services Department failed to include the intangible asset in the inventory report as part of the System's asset since they were not notified by the Controllership Department about its recognition having met the definition of an asset. As a result, the asset doesn't have any identification as to asset/property number.

11.4 The document for the payment of the transaction did not clearly state the kind of expenditure to allow proper recording and avoid confusion in recognition.

**11.5 We recommended that Management:**

**a. Include the accounts intangible asset and amortization in the chart of accounts of the system; and**

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

11.6 By way of rejoinder, we acknowledged the action initiated by Management for the adjustment of the acquisition cost but the end-user should identify first the nature of the payment amounting to P3.197 million and accordingly adjust the same to the proper account.



12. **Transfer Certificates of Titles (TCTs) were not yet consolidated in the name of AFPRSBS. Other deficiencies were also noted in the lists of TCTs, thus, ownership of properties cannot be ascertained, therefore the propriety and reliability of the System’s Acquired Assets and Investment in Real Estate account balance amounting to P422.724 million and P6.780 billion, respectively as at December 31, 2014 is doubtful, contrary to the Conceptual Framework for Financial Reporting. Further, the System’s interest and of its members are not safeguarded.**

12.1 **Land title** refers to that upon which ownership is based. It is the evidence of right of the owner or the extent of his interest, and by which means he can maintain, control and as a rule assert right to exclusive possession and enjoyment of the property. To the purchaser, the only legal truth upon which he has to rely is that the land is registered in the name of the seller and that the title under the law is absolute and indefeasible (*Registration of Land Titles and Deeds, Narciso Pena, 1982 edition*). By this definition, registration is necessary to vest and transfer ownership from the seller to the buyer.

12.2 Meanwhile, Chapter 3, QC 19 of the Conceptual Framework for Financial Reporting provides that comparability, verifiability, timelines and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

12.3 Inventory of the TCTs currently kept inside the vault of the Internal Records Management Department (IRMD), which supports the Acquired Asset and Investment in Real Estate of the System amounting to P422.724 million and P6.780 billion, showed that:

- a. The inventory list is not updated as of the inventory count date, such that:
  - Permanent and temporary releases of titles were not reflected in the list.
  - Custodian in charge has to look first at their files to verify any changes in the list.
- b. The inventory list contains inaccuracies casting doubt on its reliability for controlling and monitoring purposes:
  - Some TCTs were listed under two different names:

TCT No.	Listed under
89505	Anaped/Madison Finance Corporation and Gapay, Nicolas
51187	
85907	

Physical Inventory Listing of RSBS Titles as of December 5, 2014 showed that Anaped/Madison Finance Corporation and Gapay, Nicolas

Account have the same TCTs under their account. Further, investigation showed that Gapay, Nicolas is the registered owner of Anaped/Madison Finance Corporation.

- There were wrong encoding of TCT numbers in the list:

NAME OF PROJECT	TCT No.	
	Per Inventory	Per List
Eastridge Golf Village	643089	643088
	M-85977	M-85077
	M-85978	M-85078
	M-85979	M-85079
	M-85980	M-85080
	M-86029	M-86027
Gapay, Nicolas	51188	85907
Orchard Residential	T-917828	T-917928
Small Business Loan Account	137-2012008716	137-2012008715
	058-2013001527	OCT-2347

- There were no/wrong identification of registered owners of the TCTs in the list:

NAME OF PROJECT	TCT No.	Listed Owner	
		Per Inventory	Per List
Eastridge Golf Village	M-85879	First Countertrade, Inc.	API
	M-85880		
	M-85881		
	M-85882		
	M-85886		
	M-85887		
	M-85888		
Small Business Loan Account	137-2012001864	RSBS	Rommel Lingad
	OCT-2347		D. Martinez
	136-2012000508		Paciencia Sia
	136-2012000509		
	136-2012000510		
	136-2012000511		
	136-2012000512		
	136-2012000513		
	136-2012000514		
	136-2012000515		
	136-2012000516		
	136-2012000517		
	136-2012000518		
	136-2012000519		
136-2012000520			
Sta. Rosa Homes	T-302465	21 <sup>st</sup> Century Resources and Development Corporation	RSBS
	T-302466		
	T-302469		
	T-302470		
San Lorenzo South Subdivision – Phase 1-C	T-303187	RSBS	None
	287518		
	329557		
	060-2013015898	RSBS	RSBS/TICBI/VRC

NAME OF PROJECT	TCT No.	Listed Owner	
		Per Inventory	Per List
Villa Caceres	484243	RSBS	RSBS/Moldex
	541064		
	T-598727	RSBS/Moldex	RSBS
	T-598728		
	T-598729		
	T-598791		
	483773		
	T-483799		
	T-541251		
	T-645485		
	T-728312		
	T-728327		
	T-728333	Moldex	RSBS
	T-541178		
	T-541365		
	T-525004		
	T-728278		
	T-728283		
	T-728287		
	T-728293		
T-728313			
T-728274	RSBS		

- There were cancelled TCTs included in the list for Mt. Zion (RT-1759) and Sta. Rosa Homes (T-499663).

- c. Out of the 6,626 verified TCTs, 1,889 titles or 28.51 per cent are still in the name of Antipolo Properties, Inc. now Prime East Properties, Benjamin 9, Monterrosa Development Corporation, Eastridge Golf Village and many others while another 230 titles or 3.47 per cent are shared with the System's JV partners, details follow:

NAME OF PROJECT	Per Inventory Count	RSBS	RSBS and JV Partners	With Original Owners
Benjamin 9 – Pampanga	1,320	474	-	846
Calidguid, Evelyn Account	11	-	-	11
CEMX Property - EIMO Account	6	2	-	4
Chinatown Steel Towers, Inc.	10	-	-	10
Eastridge Golf Village	103	-	-	103
Gapay, Nicolas Account	3	-	-	3
Green Meadows – Iloilo	72	72	-	-
Hermosa, Bataan Property	2	-	-	2
Isla Philcons Holdings	22	-	-	22
Malayan Integrated, Inc.	1	-	-	1
Marilaque/API Property	14	-	-	14
MDC Venture Corporation - EIMO Account	1	-	-	1
Monterrosa Dev't Corporation	1	-	-	1
Morong, Rizal - RSBS Shares	62	-	-	62
North Matrix Village 1	63	59	-	4
Paredes, Zosimo Account	1	-	-	1
Philcons Finance	78	-	-	78
Philippine Asia Pacific Corporation	519	-	-	519

<b>NAME OF PROJECT</b>	<b>Per Inventory Count</b>	<b>RSBS</b>	<b>RSBS and JV Partners</b>	<b>With Original Owners</b>
RCJ Bus Lines, Inc.	1	-	-	1
Riviera Buyer's Name	39	-	-	39
RSBS Land, Inc.	2	-	-	2
San Lorenzo South Subdivision (SLSS)- Buyer's Name	25	-	-	25
SLSS - Phase 1	67	64	2	1
SLSS - Phase 1C	201	123	77	1
SLSS – Rawlands	40	31	2	7
San Mateo Project	78	67	-	11
Shade Project	5	2	-	3
Small Business Loan Account	39	33	-	6
Sta. Rosa Homes	137	108	-	29
Superior Pharmacy, Inc.	1	-	-	1
Villa Caceres	404	211	149	44
Villa de Toledo	138	137	-	1
Village East III - 1st Assignment/ API	592	556	-	36
<b>TOTAL</b>	<b>4,058</b>	<b>1,939</b>	<b>230</b>	<b>1,889</b>

- d. 14 titles were counted during the inventory taking but were not included in the list provided by the IRMD, as follows:

<b>NAME OF PROJECT</b>	<b>TCT No.</b>
Small Business Loan Account	004-2014001498
	090-2012001959
San Lorenzo South Subdivision – Phase 1C	060-2014027512
	287878
	T-540799
Riviera Buyer's Name	T-580392
Orchard Residential	T-917836
	T-918838
Calamba-Tanauan Property	409162
Villa de Toledo	060-301870
	060-301868
	060-301876
	060-301886
	060-2013027118

- e. As in prior year's findings, TCT No. 409162 is still not included in the list.
- f. In the case of Riviera (rawlands), 29 titles were acquired by the System in 1996 to 1997 and are considered owned by the AFPRSBS having been paying for the real property tax. However, court hearings being handled by the Office of the Government Corporate Counsel (OGCC) are still on-going for its judicial titling, thus, still in the name of private individuals.

12.4 Meanwhile, two owners are indicated in TCTs Nos. 488658 and 488675 for a land located in San Lorenzo South Subdivision, as follows:

<b>TCT No.</b>	<b>Area</b>	<b>Registered Owner</b>
T-488658	26,473 sqm.	Consuelo Macapagal/AFPRSBS
T-488675	7,057 sqm.	Gorgonia Barraquio/AFPRSBS

- a. In TCT No. T-488658, RSBS has an ownership rights to over 20,000 sqm. while Consuelo Macapagal owns the remaining 6,473 sqm. On the other hand, RSBS and Gorgonia Barraquio have a 50:50 share in the 7,057 sqm. residential lot under TCT No. T-488675.
- b. Inquiry with the personnel from the Property Management Enhancement (PMED), the two lots have not been subdivided as of year-end. Based on records on file, the System correctly pays for its share in the real property tax (RPT) for TCT No. T-488658. However, this is not the case for TCT No. T-488675 as the System is the one paying the entire RPT on the land since 2008, which should not be the case as it does not own the entire lot.
- c. Having two owners on the undivided lot may give rise to additional expenses and burden in subdividing the lot and problems in the payment of real property tax and eventually its disposal through sale. Disposal of these real estate properties is hindered by the unavailability of the land titles in the name of the AFPRSBS in addition to stiff competition in the market.
- d. For the undivided lot, the PMED commented that the System is now in the process of subdividing the lot. An amount of P170,000 for the survey of the land is included in the System's Annual Procurement Plan for CY 2015. The survey of the land is the initial step for the eventual division of the two lots.

12.5 The foregoing deficiencies casts doubt on the propriety and reliability of the System's reported Acquired Assets and Investment in Real Estate amounting to P422.724 million and P6.780 billion, respectively as of December 31, 2014, since ownership of the recorded properties could not be ascertained and relied upon.

**12.6 We recommended that Management:**

- a. **Reconcile the listed TCTs with the recorded Acquired Assets and Investment in Real Estate to ensure ownership and correctness of the account balance;**
- b. **Ensure that all movement of land titles in the custody of IRMD are up to date so that at any given point in time the Inventory List can be relied upon and ascertain ownership;**
- c. **Prioritize the transfer of all the TCTs in the name of AFPRSBS to safeguard its ownership and facilitate its easy disposal in the event of sale;**
- d. **Correct the inaccurate information contained in the Inventory List and include therein the titles not previously reported/recorded; and**
- e. **Continue and fast track the process of subdividing the two lots shared with other owners and registering the same for each sole ownership.**

12.7 Management commented that the inventory list provided by IRMD contains the available TCTs in the vault. Once titles are released temporarily or permanently, those are taken out from the list of available TCTs. Separate lists for permanent and temporary releases of TCTs complete with attachments are also being maintained. This explains as to why the custodian has to check first from the temporary and permanent releases lists when tracing for TCTs.

On the (i) TCTs which were listed under two different names (Gapay and Anaped); (ii) wrong encoding of TCT numbers in the list; and (iii) no/wrong identification of registered owners of the TCTs in the list, these were already corrected/updated by IRMD.

On the observation that there were cancelled TCTs included in the list for Mt Zion (RT-1759) and Sta. Rosa Homes (T-499663) – The two TCTs are still included in the list because the original owner's copies are still in the vault. IRMD has no knowledge of their status not until a request for release/verification is received from the managing units. IRMD shall refer to PMED the said observations with regard to the TCTs in order to comply with the COA recommendation.

The 14 titles that were counted during inventory taking but were not included in the list provided by IRMD were on temporary release status when the list was done, thus, were not in the list provided to the Aitors. However, the 14 titles have been transmitted back to IRMD and are already included in the list.

PMED is continuously undertaking title transfer of TCTs to AFPRSBS name. This is part of the deliverables of this Department in the perfection of the ownership of the AFPRSBS properties

On the lots shared with other owners, PMED is working on the subdivision of the properties for the eventual registration of the same in the name of AFPRSBS.

12.8 By way of rejoinder, considering the length of time that the TCTs have been in the hands of the System, we believe that all of the TCTs should have been transferred/consolidated in the name of AFPRSBS, hence, our recommendation above. We believe, further, that the format of the inventory listing in its present form needs to be improved and enhanced to avoid the noted discrepancies. The changes to be made in the listing by the IRMD are thus considered.

**13. Membership contributions (MC) records of ten sampled members for CY 2014 are unreliable due to gaps and deficiencies noted in the verification of transactions, thereby, affecting the members claims of benefits upon retirement.**

13.1 The Membership Group (MG) of the AFPRSBS is in charge of ensuring refund of members' contribution based on accurate and complete members information and records until amendment of the System's governing laws.(underscoring for emphasis)

13.2 To achieve this goal, the MG undertakes to: a) complete the uploading of monthly member's contribution in the System's database; b) regulate the interest rate for

members' refund to parallel with prevailing market rates; and c) continue to conduct information drives and maintain close rapport with AFP units.

13.3 Results of questionnaires sent out and interviews conducted with MG are summarized as follows:

- Procedures in uploading of MC:
  - a. The data format or structure of the soft copy of the Remittance List is converted to a text file and transmitted to the Database Administrative Branch of the Management Information System Office (MISO) for uploading to the IFMS.
  - b. MISO uploads the converted data file to IFMS Membership Module data base, making reference to the OR issued by Treasury Department (TD). Successful uploading yields a certain number of valid and invalid records. Valid records are immediately electronically posted to the individual MC Ledger (MCL) of contributing members. Invalid records on the other hand go through a revalidation process before these are posted to the MCL. The reasons for the invalid records are indicated in the IFMS Validation Summary Report such as discrepancy in name; AFP serial number already exists and invalid AFP serial number, etc. To verify discrepancies/invalid records, the following sources of records can be used:
    - Print-out of Remittance List
    - Records in the IFMS Membership Database
    - Records in the old Membership Management System (MMS)
    - Verification/Certification from the Major Service Adjutants of the AFP
    - Verification / Certification from the Non-Current Records Division (NRD) of the AFP
    - Verification from the Pension Gratuity Management Center (PGMC)
    - Verification / Securing of Records from the Philippine Statistical Authority (formerly National Statistics Office) such as Birth Certificate, Marriage Certificate, Advisory of Marriages, Death Certificate, etc.
  - c. The issuance and assignment of serial numbers of the AFP personnel is solely the responsibility of the AFP. On the other hand, the Membership ID Number is an electronic control number which is automatically assigned by the application program of the IFMS once a new member or claimant is added. In case two or more Membership ID Numbers are assigned to the same member or claimant, the records are verified first and if found to belong to the same person, the records are consolidated into one. This happens because there are only three validation fields in the IFMS namely, Last Name, First

Name and the AFP Serial Number (AFPSN). The middle name or middle initial is not included as a validation field in the IFMS.

In case of promotion from enlisted personnel to officer position, the AFP Serial Number changes and this is solely determined by the AFP. However, on IFMS program, the member's Membership ID Number does not change with promotion.

- For remittances with Gaps

In case of gaps in remittances as found in the MCL, the contributions are manually inputted based on the member's Statement of Service. Thus the computation of refund of member's contributions is based on both the member's Statement of Service with the AFP and the MCL posted contributions. If there are no posted contributions in the MCL, the refundable contributions are computed based solely on the Statement of Service.

13.4 Approved Disposition Form (DF) dated April 16, 2014 re: Processing of refund claims (with significant number of unrecorded member's contribution) provides the guideline/procedure in inputting remittances with gaps in the members' contribution ledger:

Paragraph 1.3.1 of the DF provides the new guidelines to process the refund claims.

- The recorded/posted contributions in the CIW shall include all uploaded contributions and manually encoded un-posted contributions for a given year based on the member's Statement of Service.

- Manual encoding of contributions will be done only if there are posted contributions for at least 6 (six) months for the year covered.

- The unrecorded/un-posted member's contributions shall be treated as retention and shall be processed and refunded to the member-claimants as soon as the remittances are validated and posted to the ledgers.

13.5 Random test check on individual member's data/records within AFPRSBS IFMS – Membership Module revealed the following observation.

a. Member's name was entered in the IFMS twice with single AFP SN, but with different RSBS membership ID;

b. Two AFP SN were assigned to one AFPRSBS members, with two different RSBS membership ID;

c. One AFP SN was assigned to two AFPRSBS members; and

d. Further, it was observed that some member's ID appears to be different from the others (i.e. IND-20101200064 – CONDE, MACARIA B.) and without AFP SN. According to MD these occur for members who died in the service and



whose contribution's claimant is the immediate family member or legal beneficiary. Per IFMS – the category type is NON-MEMBER.

13.6 Moreover, inspection of 10 MCL showed significant numbers of unrecorded member's contribution. The MCL have gaps and without reference to official receipt evidencing the remitted contributions.

13.7 The System owe it to its members to have a complete, updated and accurate MCL since this is the basis/source information in the computation of the members refund of contribution and the corresponding interest thereon, thus, failure to do so affects their claims benefits.

**13.8 We recommended that Management fulfill its objective of maintaining a reliable and accurate membership database:**

**a. Include data entry validation control in the current system to immediately detect remittances with incomplete or invalid data and/or duplicate records; and**

**b. Coordinate with the remitting agencies in securing complete and reliable data of its members.**

13.9 Management commented that with regard to the recommendation to include data entry validation control in the current system to immediately detect remittances with incomplete or invalid data and/or duplicate records, the MG will make the necessary coordination with MISO to possibly enhance the features of IFMS. Currently, the IFMS has the capability to detect invalid records but revalidation of invalid records is done manually. If the revalidation process could be automated and included as enhanced feature of the IFMS, then the number of invalid records will be reduced accordingly.

### ***Compliance Audit***

**14. The continued withdrawal of gasoline by private vehicles from the AFP Commissary and Exchange Services (AFPCES) totaling P0.316 million is contrary to Section 4(2) of Presidential Decree (PD) 1445 and Section 7 of COA Circular No. 77-61 dated September 26, 1977, hence considered irregular expenses, as defined under Section 3 of COA Circular 2012-003 dated October 29, 2012.**

14.1 Section 4.2 of Presidential Decree 1445 states that xxx "Government funds or property shall be spent or used solely for public purposes."

14.2 Section 7 of COA Circular No. 77-61 prescribing the manual on the audit of fuel consumption states that:

*"No disbursement voucher for fuel consumption (gasoline and oil) shall be allowed in audit unless duly supported by properly accomplished and approve serially numbered driver's trip tickets, and that the government vehicles involved are plainly marked For Official Use Only and bear*

*government plates only with the exception of security vehicles exempt from using government plates.”*

14.3 Section 3 of Circular 2012-003 dated October 29, 2012 on Updated Guidelines for the Prevention and Disallowance of Irregular, Unnecessary, Excessive, Extravagant and Unconscionable Expenditure (IUEEUE) defines “Irregular Expenditures” as:

*“An expenditure that is incurred without adhering to established rules, regulations, procedural guidelines, policies, principles or practices that has gained recognition in laws. Irregular expenditures are incurred if funds are disbursed without conforming with prescribed usages and rules of discipline. (underscoring supplied)”*

14.4 Moreover, there is no observance of an established pattern, course, mode of action, behavior or conduct in the incurrence of an irregular expenditure. *A transaction conducted in a manner that deviates or departs from, or which does not comply with standards set is deemed irregular.* A transaction which fails to follow or violates appropriate rules of procedures is likewise, irregular.

14.5 Analysis of the account and verification of the Gas Slip showed that during the year, owners of “private vehicles” had withdrawn gasoline worth P316,434 from the AFPCEs, the official gasoline depot of the System. Details as follows:

<b>Withdrawn by</b>	<b>Amount</b>
President and CEO	P 130,601
Executive Vice Pres. (EVP)	122,876
Other personnel	62,957
<b>Total</b>	<b>P 316,434</b>

14.6 The appointment papers of the President and CEO and Executive Vice President signed by the Secretary of National Defense showed that among the benefits that they are entitled to, is a fixed monthly allocation of 300 and 250 liters of gasoline, respectively, which shall be non-cumulative.

14.7 It is for this authority that the President and CEO and EVP were given 30 and 25 gasoline slips of 10 liters each at the beginning of each month with no specific vehicle recipient. Thus, interview with the personnel from the General Services Department disclosed that they have no way of knowing who will avail of the gas slip, not until the gas slips are returned together with the Statement of Account from the gasoline depot.

14.8 Meanwhile, the Report on Salaries and Allowances (ROSA) granted to the President and CEO and EVP showed that both are receiving monthly representation and transportation allowance of P20,400 and P19,900 respectively.

14.9 Notwithstanding said entitlement to fuel allocation, the fact that they were already recipient of transportation allowance (TA) no longer permit them to avail of such gasoline allocation since it is tantamount to double compensation/benefit as decided upon on November 27, 1992 in the case of Bustamante vs COA, 216 SCRA 134, to wit:

*“It was held that transportation allowance claimed by the legal counsel of National Power Corporation was disallowed in audit because he was already issued a government vehicle. It stressed that the use of government motor vehicle and claim for transportation allowance are mutually exclusive and incompatible.”*

14.10 The case is similar with that of the President and CEO and EVP. Although they are not using government vehicle, they are withdrawing gasoline for their own private vehicle and receiving transportation allowance at the same time.

14.11 The continued withdrawal of gasoline as reported in prior year on top of the monthly transportation allowance claimed constitutes an irregular expenditure. The amount of P316,434, corresponding to the gasoline withdrawn will therefore be disallowed in audit.

14.12 **We recommended that the officers concern:**

- a. Refund the amount of P316,434 representing the value of gasoline withdrawn; and**
- b. Stop the practice of withdrawing gasoline and claiming transportation allowance.**

14.13 Management commented that the withdrawal of the monthly gasoline allowance by the President and the Executive Vice President (EVP) worth P253,477 was in good faith since this is among the benefits that they are entitled to as provided for in their appointment papers. The said entitlement is the same privilege that was granted to the previous officers of the System.

The granting of gasoline allocation to private/personal vehicles for official trip(s) cannot at all be avoided due to insufficiency of company-owned service vehicles. This is being done so as not to hamper the activities of the requesting units.

The System tried to resolve the problem on the lack of service vehicles by including a P1,800,000 budget in the 2014 Corporate Operating Budget for the procurement of an additional vehicle. However, the same was stalled pending the resolution of the queries that were raised by the Department of Budget and Management (DBM). Further, some vehicles have undergone repairs during the year resulting in the unavailability of vehicles in some periods.

The management, therefore, affirms that all issuances made to private vehicles as authorized and that the personnel identified by the auditors (President, EVP & owners of private vehicles) should not be required to refund the corresponding amount of the issued gas allocations.

14.14 As a rejoinder, we took note of Management’s predicament on the insufficiency of service vehicles, however, we maintain our position that government expenditures should at all times adhere to laws, rules and regulations.

**15. The policy of granting cash gift to birthday celebrators/employees is not anchored on a statutory authority and the amount of P0.190 million given for CY 2014 is not among those allowances, incentives and other benefits expressly authorized by law and contrary to COA Circular No. 2013-003 dated January 30, 2013.**

15.1 Personnel Policy No. 01-02-91 dated January 4, 1991 on the subject birthday gift provides that:

- I. Policy Statement – The System shall extend individual greetings and share in the celebration of the employees’ natal days by granting a substantial amount of birthday checks to eligible employees.
- II. Eligibility –
  - All regular employees, both male and female
  - Employees who have been granted study leaves and extended maternity leaves by the President
- III. Exclusion – Probationary and contractual employees
- IV. Amount of Gift Check – shall be annually established by the Human Resource Management Office for approval by the President through the annual Short Term Planning and Budgeting Process

15.2 Section II of COA Circular No. 2013-003 dated January 30, 2013 on the subject Reiteration of Audit Disallowance of Payments without Legal Basis of Allowances, Incentives, and Other Benefits of Government Officials and Employees in the NGAs, LGUs, and GOCCs and their Subsidiaries states that:

II. Entitlement to Allowances, Incentives, and Other Benefits

Government officials and employees shall be entitled only to allowances, incentives, and other benefits expressly provided by law, and other statutory authority, and the rules and regulations promulgated by competent authority.

15.3 For CY 2014, the System granted cash gift to birthday celebrators totaling P190,000 which is not among those authorized by law or any other statutory authority to make the expenditure legal and the issuance of Personnel Policy not anchored on a statutory authority does not make it legal, therefore the disbursement covering payment for birthday cash gift totaling P190,000 is not allowed.

**15.4 We recommended that Management:**

- a. **Submit authority for the granting of cash gift to birthday celebrators/ employees; otherwise,**
- b. **Stop the granting of said benefit and refund the amount of P190,000 granted for CY2014.**

15.5 Management commented that the grant of birthday cash gift to RSBS employees has been part of the compensation and benefits package of regular employees when it was still operating as a private institution. Hence, in view of the principle of non-diminution on salary and benefits, even after the RSBS was already declared as government institution, RSBS policies pertaining to salaries and benefits not present in the structure of the government were continued to be provided to employees. Removal or discontinuance of the said benefit due to the System's change of organizational status contravenes the principle of non-diminution of benefits and non-impairment of vested rights.

15.6 As a rejoinder, the Salary Standardization Law (SSL) increased the salaries of government employees and included therein the allowances previously received and proclaimed allowances that maybe granted during the years. Moreover, only those receiving allowances prior to the SSL can be given previously granted allowances which were not incorporated in the SSL.

**16. Grant of cell card subsidy to an existing post-paid subscription plan holder and payment of communication allowance during official travel to recipient of cell card subsidy constitute excessive expenditure as COA Circular No. 2012-003 dated October 29, 2012, and is contrary to the System's policy on efficient use of communication facilities, thus its continuous payment will deny the System of funds for its operation.**

16.1 COA Circular No. 2012-003 dated on Excessive Expenditures states that:

5.0 Excessive Expenditures

*The term "excessive expenditures" signifies unreasonable expense or expenses incurred at an immoderate quantity and exorbitant price. It also includes expenses which exceed what is usual or proper, as well as expenses which are unreasonably high and beyond just measure or amount. They also include expenses in excess of reasonable limits.*

16.2 The policy of the System to provide its personnel with appropriate communication capability in the discharge of their duties and responsibilities within and outside of office premises is contained under Document No. P-2004-03 dated October 11, 2004. Salient features are as follows:

xxx

*B.1.4.b Units with special activities, assignments or coordination that are done in the normal day-to-day activities of the System (1.e, open house launching, inaugurations, signing ceremony, planning, restructuring committee, etc) and conducted outside of RSBS may request for a prepaid cell card to be used specifically for the stated purpose and duration of the project provided that:*

*B.1.4.b.1 employee authorized to receive the cell card subsidy shall not be a recipient of a cell card requested for the activity.*

xxx

B.1.4.c.1 Employees handling multiple committees or assignments shall be granted only one (1) cell card subsidy.

**B.2 Post-Paid Subscription**

B.2.1.a Only the three top executives shall be allowed post-paid subscriptions

xxx

B.2.3.a Rates for post-paid subscriptions shall be based on the maximum amounts per month approved for the year in review

xxx

B.2.4.a Any amount exceeding that of the allowable limit shall be for the account of the user.

xxx

B.3.3.a.2 Even if the executive shells out money to buy his recommended unit, the cellphone is still considered fully-owned by the company.

16.3 Meanwhile, Disposition Form Ref. No.317-03-20-2003 on Enhancement on the Old Travel Allowance Policy approved the grant of communication allowance (CA) of P150 per day (inclusive of calls and transportation expense within the destination's vicinity).

16.4 Review of the Telephone/Communications account for the year disclosed that a post paid subscription plan holder is also a recipient of a cell card subsidy. Likewise, certain departments/units were also provided with cell card allocation on top of the allocation already given to its officers. Details as follows:

<b>Office</b>	<b>Post Paid</b>	<b>Card Subsidy</b>	<b>Total</b>
President and CEO	P 45,977	P 24,000	P 69,977
PMED		9,600	9,600
AMD		11,000	11,000
MG		11,000	11,000
Legal Department		5,400	5,400
MSD		8,400	8,400
<b>Total</b>	<b>P 45,977</b>	<b>P 69,400</b>	<b>P 115,377</b>

16.5 Moreover, the following Officer/personnel were granted communication allowances during their official travel in addition to the monthly cell card subsidy provided them and their office.

<b>Office/(r)</b>	<b>Card Subsidy</b>	<b>Claimed during travels</b>
Corporate Secretary	P 1,200	P 2,250
Office of the Legal Department	600	-
Lawyer 1	300	750

Office/(r)	Card Subsidy	Claimed during travels
Lawyer 2	300	600
Employee 1	500	600
<b>Total</b>		<b>4,200</b>

16.6 With regard to the post-paid plans for the Office of the President and CEO, the audit disclosed that the contract for the plan was made out in the name of the end-user and not in the name of the System, in which case, the contract does not bind the System, thus the bills are not proper charges to AFPRSBS. Otherwise, since it is the System which shoulders the bill, the contract should have been made out in the name of AFPRSBS and the cellphone that comes with the plan should be recorded as government asset and covered by Memorandum Receipt.

16.7 Moreover, there is no amount set as limit with regard the use of mobile telephone. The monthly expenses range from P2,499 to as high as P7,361 for the period July 21 to August 20, 2014.

16.8 The grant of additional cell card allocation to the five offices in addition to the cell card subsidy already received by their officers constitutes excessive claim for the department concerned.

16.9 Likewise, the claims for communication allowance while on official travel by those officer and personnel who are already recipients of cell card subsidy violated B.1.4.b.1 of their own policy.

16.10 **We recommended that Management:**

- a. **Stop the grant of cell card subsidy to post-paid plan holder;**
- b. **Refund the amount of P24,000 for cell card subsidy given to post-paid plan holder and the amount of P4,200 for official/personnel who claimed communication allowance during travels;**
- c. **Execute the contract of the post paid plan in the name of the System and issue Memorandum Receipt for the cell phone and record as part of the asset of the System;**
- d. **Set a maximum limit to the post-paid plan and any amount in excess of the set limit should be shouldered by the end-user;**
- e. **Assess the need for the additional allocation in the name of the office/department to establish accountability; and**
- f. **Discontinue the grant of communication allowance while on official travel to those who are already recipients of cell card subsidy.**

16.11 Management commented that it will abide by the recommendation of COA and that starting April 2015, the General Services Department (GSD) shall no longer release cell card subsidy to post-paid plan holder.

On the communication allowance claimed by personnel from Legal Department and the staff of the Iloilo field office during travel, the System is of the opinion that the grant of communication allowance during official travel is not excessive and thereby must not be disallowed. Further, the telecommunication rates differ when making calls from cellular phones outside Manila to landlines.

Meanwhile, the monthly cell card subsidy that was granted to the post-paid plan holder in the amount of P24,000.00 was not solely for the primary use of the holder but was given to staff who needed to get in touch with the Head of the Agency during meetings outside of RSBS premises. The allocation was also used by staff to contact constituents, clients, and officers to confirm or convey important messages when contact thru landline was not possible. Thus, Management is requesting consideration for the card subsidy given to post-paid plan holder and the amount claimed for communication allowance during travel for the year 2014.

The GSD will coordinate with the provider of the post-paid line that was issued to the President and CEO for the possible change of name (to AFPRSBS) in the contract that was executed. The GSD has already prepared the MR, now Acknowledgement Receipt for Equipment, to document the issuance of the unit and the same will be recorded by the CD as part of the asset of the System.

The Corporate Planning Office, in coordination with the concerned operating units, will revisit and enhance the existing policy on efficient use of communication facilities and the issue on communication allowance while on official travel. This includes the setting up of the maximum limit to post-paid plan unit(s) and the possible increase in the cell card allowance for departments/offices that frequently deals with external clients.

On the additional allocation issued to the different departments, the System justified that it was able to cut cost since landlines were more expensive in reaching out to their clients and business dealings in the performance of their duties.

**17. The System failed to comply with the required submission of contracts/purchase order (PO) and supporting document to COA within five days upon perfection thereof pursuant to COA Circular 2009-001 dated February 12, 2009. Moreover, no Requisition and Issue Voucher (RIV) were prepared for the System's requirement prior to purchase while POs were not duly acknowledged received by the Supplier, thus, denying imposition of penalties in case of delays in delivery contrary to Section 68 of RA 9184.**

17.1 COA Circular 2009-001 dated February 12, 2009 states that:

*"The audited agencies are required to furnish the Auditor with a copy of perfected contracts and purchase orders within five (5) working days upon approval together with the supporting documents for review."*

17.2 Sec. 68 of Republic Act (RA) 9184 requires that all contracts executed in accordance with the Act (R.A. 9184) and its IRR shall contain a provision on liquidated damages which shall be payable by the contractor (supplier) in case of breach thereof.



17.3 Review of transactions showed that the System did not submit copies of all its perfected contracts and Purchase Orders (PO) within five working days as required by the aforementioned Circular. While it is understandable that audit of the System is on a team approach basis, certified true copies of all contracts could have been forwarded to the Commission for compliance purposes.

17.4 Moreover, examination of documents supporting procurement transactions disclosed the following:

a. The System does not prepare Requisition and Issue Voucher (RIV). Per inquiry from the GSD, what they have is the Requisition and Issue Slip which is used in the issuance of office supplies.

b. POs for the procurement of goods and services were not properly acknowledged as received by the contracting party (signed and date received). As a result, liquidated damages cannot be imposed if and when the contracting party did not comply with the delivery date as prescribed under Section 68 of RA 9184

17.5 **We recommended which Management concurred to:**

a. **Comply with COA Circular 2009-001 to furnish COA with certified true copies of all contracts and POs;**

b. **Have all POs duly acknowledged received by the supplier and indicate date of receipt; and**

c. **Prepare RIVs to support POs and proof of requisition of end-users.**

### ***Implementation of GAD Plan and Budget***

**18. The AFPRSBS has not prepared the Annual Gender and Development (GAD) Plan. Moreover, GAD concerns were not incorporated in the System's Revenue, Expense, Capital Outlay and Cash Flow Budget (Corporate Operating Budget) as required by Executive Order No. 273 dated September 8, 1995 and Joint Circular No. 2004-01 dated April 5, 2004.**

18.1 Executive Order (EO) No. 273 approved and adopted the Philippine Plan for Gender-Responsive Development (PPGD 1995-2025) which mandated agencies to incorporate and reflect GAD concerns in their agency performance commitment contracts, annual budget proposals and work and financial plans.

18.2 Joint Circular No. 2012-01 prescribe the guidelines and procedures for the formulation, development, submission, implementation, monitoring and evaluation including accounting of results of agency annual GAD plans and budgets and GAD accomplishment reports. It also provides the mechanics for the development of programs, activities and projects to respect, protect and fulfill the rights of women at the socio-cultural, economic and political spheres.

18.3 Item 2.3 of the Joint Circular provides that – Pursuant to the Magna Carta of Women (MCW) or Republic Act 9710 and the General Appropriations Act (GAA), all government departments, including their attached agencies, offices, bureaus, state universities and colleges (SUCs), government-owned and controlled corporations (GOCCs), local government units (LGUs) and other instrumentalities shall formulate their annual GAD plans and budgets within the context of their mandate and overall plans and programs. The annual GAD plan and budget shall be geared towards the achievement of the desired outcomes and goals as identified in the Framework Plan for Women.

18.4 GAD planning shall be integrated in the regular activities of the agencies, the cost of implementation of which shall be at least five per cent of their total budget appropriations. The computation and utilization shall be implemented in accordance with the specific guidelines provided therein.

18.5 Verification of the System's Revenue, Expense, Capital Outlay and Cash Flow Budget (Corporate Operating Budget) disclosed that no fund was set aside for gender and development as required under EO 273 and Joint Circular 2002-01, thus, the government objective to respect, protect and fulfill the rights of women at the socio-cultural, economic and political spheres, is not adhered to.

**18.6 We recommended that Management formulate/prepare Annual GAD Plan and Accomplishment Reports in compliance with EO 273 and Joint Circular No. 2012-01 and include GAD concerns in the Systems Corporate Operating Budget.**

18.7 Management commented that in view of the winding down operation and impending deactivation of the System by December 2016, the Human Resources Office did not anymore propose for a separate gender and development program. Instead, a budget for employee development which include gender and sports development, soft and technical training and other social activities for both male and female employees were included in the 2015 Corporate Operating Budget. Management requests for consideration of the Gender and Sports Development Budget for 2015 in view of the mission of the System to wind down its operations.

18.8 We took note of Management comment and further suggests that the given activities should be aligned with the prescribed GAD Plan of the government and should be endorsed by the Philippine Commission on Women to the DBM.

## **19. Status of Suspension, Disallowance and Notice of Charge**

The Commission Proper (CP), Commission on Audit (COA), en banc issued a Resolution on February 27, 2015, which reads as follows:

COA CP Case No. 2012-175 – Motion for reconsideration of the then Acting Head, Office of the Internal Auditor, Armed Forces of the Philippines-Retirement and Separation Benefits System (AFPRSBS), through Counsel, of Commission on Audit Decision No. 2012-188 dated November 5, 2012 which denied her request for exclusion from liability in Notice of Disallowance (ND) No. 2010-07-084-(1996) dated July 28, 2010 on the overpriced land acquisition by AFPRSBS in the total amount of P250,318,200.00.