

## OBSERVATIONS AND RECOMMENDATIONS

**1. The System does not consolidate its financial statements with the financial statements of its subsidiaries and controlled entities where it has invested a total of P2.477 billion. Moreover, the investment account is overstated by P15.154 million due to the non-elimination of reciprocal accounts contrary to the pertinent provisions of the Philippine Financial Reporting Standards (PFRS) 10 - Consolidated Financial Statements. Hence, the System's financial statements do not present reliable and accurate financial conditions and the results of its operations as of and for the year ended December 31, 2016.**

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 Standard 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 the System and its accompanying notes as of December 31, 2016 disclosed that the System has a total investments in stocks of its subsidiaries and affiliates/controlled entities totalling P2.477 billion, details follow:

Subsidiaries and Affiliates/Controlled Entities	Percent of Ownership	Cost of Investment	
		2016	2015
Monterrosa Development Corporation (MDC)	100.00%	873,927,445	873,927,445
Resources Investment House (RIH)	100.00%	102,123,549	102,123,549
RSBS Land, Inc. (RLI)	100.00%	994,170	994,170
Fashion Link Corporation (FLC)	100.00%	20,100,000	20,100,000
Southern Utility Management Services, Inc. (SUMSI)	100.00%	10,000,000	10,000,000
General Satellite Communications, Inc. (GENSAT)	62.00%	2,906,238	2,906,238
AFP Theater Enterprises, Inc. (ATEI)	50.00%	120,000,000	120,000,000
Bay Resources Development Corporation (BRDC)	50.00%	402,000,000	402,000,000
Amtrust Holdings, Inc. (AHI)	25.56%	127,000,000	127,000,000
<i>Sub-total</i>		<i>1,659,051,402</i>	<i>1,659,051,402</i>
Matrix Realty Development Corporation (MRDC)	100.00%	35,931,250	35,931,250
Globan Fruits and Development Corporation (GFDC)	100.00%	10,000,000	10,000,000
RSBS Enterprises, Inc. (REI)	100.00%	2,500,000	2,500,000
Veterans Electronics Communications, Inc. (Vetronix)	90.65%	126,738,598	126,738,598
Goodfit Manufacturing Corporation (GMC)	79.99%	25,556,920	25,556,920
Marilaque Land, Inc. (MLI)	40.00%	609,000,000	609,000,000
Cyquest, Inc.	40.00%	2,000,000	2,000,000
CEMX, Inc.	24.00%	6,000,000	6,000,000
<i>Sub-total</i>		<i>817,726,768</i>	<i>817,726,768</i>
<b>Total</b>		<b>2,476,778,170</b>	<b>2,476,778,170</b>

- a. The System did not submit the financial statements of its nine subsidiaries where it has invested a total of P1.659 billion as well as the detail of the accumulated equity in net losses of its subsidiaries and affiliates amounting to P540,055,100 per note 11 to financial statements, to prove the correctness of the balances of the said accounts as of December 31, 2016.

- b. Moreover, no additional information to update the financial statements was provided to properly consolidate the financial information for the remaining eight subsidiaries and affiliates contrary to paragraph 21 of PFRS 10.

1.4 Note 3.6 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 significant influence or not over the entity. Under the equity method, the System recognizes in its statements of income, its equity in the net earnings or losses of subsidiaries and associates since dates of acquisition. The difference between the System's cost of 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 P32.991 million and its allowance for doubtful accounts of P17.837 million contrary to Paragraph 21 of PFRS 10, thereby overstating the net asset account balance by P15.154 million as follows:

<b>Subsidiaries and Affiliates/Controlled Entities</b>	<b>2016</b>	<b>2015</b>
Bay Resources Development Corp. (BRADCO)	13,191,805	9,179,341
Matrix Realty and Development Corp (MRDC)	5,894,093	5,894,093
Monterrosa Development Corp. (MDC)	12,136,245	11,858,745
Veterans Electronics Communications, Inc.	1,768,761	1,768,761
<b>Total</b>	<b>32,990,904</b>	<b>28,700,940</b>
Allowance for doubtful accounts	(17,837,110)	(17,837,020)
<b>Overstatement</b>	<b>15,153,794</b>	<b>10,863,920</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, 2016.

1.9 **We reiterated our prior years' recommendations that Management:**

- a. **Prepare the consolidated financial statements to include the assets, liabilities and results of operations of its subsidiaries in compliance with the provisions of PFRS 10; and**
- b. **Eliminate all parent and subsidiary reciprocal account balances during the process of consolidation.**

1.10 We further recommend that the System 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 Securities and Exchange Commission (SEC).

1.11 Management commented the following:

a. The Equity and Investment Management Department (EIMD) will submit to the Controllership Department (CD) the 2016 audited Financial Statements (FS) of the actively operating subsidiaries and affiliates for consolidation as soon as the same are received.

b. The actively operating subsidiaries and affiliates of the System may be grouped as follows:

Group A	Group B
SUMSI	BRADCO
ATEI	MLI
MDC	EKHI
	PAL

c. The consolidated FS of SUMSI and ATEI for CY 2016 are expected to be received by EIMD soonest. For MDC, the last audited FS of the company is already for the terminal done by COA for the year 2005.

d. The System has no controlling interest over the corporations under Group B because of its minority interest. The submission of their respective audited financial statements cannot be forced but through endeavors.

e. The elimination of reciprocal account balances between the parent company and subsidiary shall be undertaken by the CD once the audited FS of SUMSI and ATEI are forwarded by this Department.

f. As regards the Statement of Affairs and the Statement of Realization and Liquidation of non-operating corporations based on the exit briefing, the System shall submit to COA the last audited financial statements of those corporations for terminal audit.

g. The license for registration of GENSAT and CYQUEST were already revoked by the SEC. Meanwhile, RICH and RLI were dissolved by SEC in 2007 and 2014, respectively. Management submitted the Certificates of Revocation and Certificates for Dissolution and the profile of equity investment together with the status updates for the year ending 31 December 2016.

2. Deficiencies noted in the submitted report of physical count of the property, plant and equipment (RPCPPE) cast doubts on the accuracy and completeness of the net balance of the property and equipment (PE) account with the net book value of P33.876 million as of December 31, 2016. There was no reconciliation between the RPCPPE and the accounting records contrary to Section 111 of P.D. 1445 and Item 4 of Section V of COA Circular 80-124 dated 18 January 1980.

2.1 Section 111 of P.D. 1445 provides that:

(1) *The accounts of an agency shall be kept in such detail as is 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.*

(2) *The highest standards of honesty, objectivity and consistency shall be observed in the keeping of accounts to safeguard against inaccurate or misleading information.*

2.2 Item 4 of Section V of COA Circular 80-124 dated 18 January 1980 requires that:

*The inventory reports shall be prepared on the prescribed form (Gen. Form No. 41-A) and certified correct by the committee in charge thereof and approved by the head of the agency. **The reports shall be properly reconciled with accounting and inventory records.** (Emphasis supplied)*

2.3 The System's book showed that the following PE accounts with a net book value of P33.876 million as of December 31, 2016, presented as follows:

Particulars	Acquisition Cost	Allowance for Depreciation	Net Book Value
Office machineries & equipment	149,058,690.69	(128,571,620.51)	20,487,070.18
Transportation / motor vehicles	8,283,852.78	(7,413,035.35)	870,817.43
Office furniture & fixtures	15,714,472.56	(12,344,996.00)	3,369,476.56
Buildings / structures	91,429,578.56	(82,286,620.70)	9,142,957.86
Books & references	158,491.37	(152,879.82)	5,611.55
<b>Total</b>	<b>264,645,085.96</b>	<b>(230,769,152.38)</b>	<b>33,875,933.58</b>

2.4 Management submitted the RPCPPE for CY 2016 which showed a total of P40.914 million and P1.797 million serviceable and unserviceable property, respectively, based on the original cost or residual value of property and equipment located at the System's Main Office, Industrial Park Management Office (IPMO) and satellite office at Iloilo City. Details of which are as follows:

<b>Classification</b>	<b>Serviceable</b>	<b>Unserviceable</b>	<b>The content of the accounts</b>
<i>Expendable items</i>			
1. Office Fixture	398,189.41	3,747.29	Staplers and its removers, scissors, drinking glasses, punchers, trash cans, flash drives, etc.
2. Calculator	31,251.00	5,200.00	Calculators issued
3. Other expendable items	2,106,011.76	7,830.15	Chairs, filing cabinets, pedestals, tables, type writers, etc.
<i>Office property and equipment</i>	1,527,092.51	460.00	Cabinets, chairs, fabric panels, fire extinguishers, grass cutters, etc.
<i>Office machineries and equipment (OME)</i>	31,216,070.64	1,780,052.00	Computers and its peripherals, phones, air conditioners, appliances, software licenses, motorcycle, tractor, etc.
<i>Transportation equipment</i>			
1. Transportation equipment	5,579,500.00		Motor vehicles and motor cycle
2. Others	55,513.00		Tools, helmet and vacuum
<b>TOTAL</b>	<b>40,913,628.32</b>	<b>1,797,289.44</b>	

2.5 Examination of the said inventory report revealed various deficiencies as follows:

- a. Most of the assets in the report are valued at P10 as its residual value due to the absence of the document/record that will provide for the acquisition cost. Also, there was no policy provided for the adoption of the said recording.
- b. Erroneous inclusion of assets in the above classification/ categories, such as:
  - i. Expendable items amounting to P398,189.41 and P3,747.29 should have been recorded either under Office Supplies Inventory and Other Supplies and Materials Inventory account, respectively;
  - ii. Other expendable items amounting to P2,106,011.76 and P7,830.15 should have been classified as Office Equipment;
  - iii. Tractor and motorcycle (Kawasaki) classified under OME valued at P10 each should have been reclassified under Transportation Equipment;
  - iv. Office machineries and equipment which includes IT Resources composed of software, hardware and peripherals amounting to

P26,482,085.70 and P989,040 should have been reclassified under Information Technology Resources; and

v. Part of transportation equipment includes the amount of P55,513 which pertains to tools, helmet and vacuum should have been categorized under Office Equipment.

2.6 Likewise, the System fails to reconcile the RPCPPE with the record per book because the CD was not able to provide the lists of PE which have the same amount as presented in the book, contrary to Section 111 of P.D. 1445 and Item 4 of Section V of COA Circular 80-124 dated 18 January 1980

2.7 Hence, both the balances presented in the PE's acquisition cost and allowance for depreciation cannot be relied upon.

2.8 **We recommended that Management:**

- a. **Require the Inventory committee to account for and classify the items included in the RPCPPE according to the category used by the CD;**
- b. **Require the CD to provide for the list of assets that represent the amount presented in the PE and its Allowance for depreciation accounts;**
- c. **Reconcile the RPCPPE and the updated records per CD; and**
- d. **Adjust accordingly the results of reconciliation.**

2.9 Management commented that the General Services Department (GSD) and the Controllership Department (CD) are continuously reconciling the PE account. GSD will adjust its Inventory Report to properly categorize the inventories to match with the classification of CD.

**3. The negative/abnormal items in some schedules, the unposted balances to individual ledger of borrowers and several accounts with no schedules totaling P7.834 billion, cast doubt on the reliability and accuracy of the respective accounts contrary to the Philippine Conceptual Framework for Financial Reporting.**

3.1 The Framework for the Preparation and Presentation of Financial Statements identifies for the fair presentation of financial statements. To achieve this framework is that the information presented meets the qualitative characteristics of financial statements. The qualitative characteristics are the attributes that make the information provided in financial statements useful to users. One of these attributes is Paragraph 31 of the Framework for the Preparation and Presentation of Financial Statements states that:

*“To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.”*

3.2 As of December 31, 2016, the following accounts were presented to substantiate the submitted schedule totaling P7.834 billion, as follows:

<b>Account Name</b>	<b>TB/GL</b>
Investment in real estate	P 6,442,339,384
Acquired asset	458,326,773
Installment contract receivable (ICR)	523,632,782
Past due loans	409,691,632
	<b>P 7,833,990,571</b>

3.3 Examination of the accounts disclosed the following observations:

- a. The number of inventory lots per square meter was not indicated in the schedule submitted by the CD to support the balance of Investment in Real Estate (RE) account. Hence, the number of available lots for sale with the Property Management Department (PMD) could not easily be reconciled. Availability of the reconciled number of inventory of lots per sq. m in the proper computation of cost of sale (COS) at any given time. The CD computed and allocated the cost of sale based on the information from the PMD which was not properly coordinated with the Asset Management Department (AMD) which may result in erroneous COS that will be charged against the Investment in RE and the COS will not be updated. It was updated only upon request for each specific sub-account.
- b. On the ICR accounts, the following observations were noted based on sample transactions:
  - i. No subsidiary ledgers were prepared for the 105 sample accounts under a Joint Venture project and various accounts of Mount Zion project amounting to P21,576,047.71;
  - ii. Undetermined amount of cancelled or rescinded ICR accounts of borrowers who failed to pay their monthly amortization were not taken up in the SL. Part of these include various adjustments or collections amounting to P5.665 million not yet posted to individual ledger of borrowers as follows:

<b>Account</b>	<b>Amount</b>
ICR - Past Due (Village East)	P 7,133,632.76
ICR – Current	(1,468,607.42)
	<b>P 5,665,025.34</b>



- iii. There were 51 sample individual ledger accounts amounting to P13,729,387 that were not reported in the schedule;
- iv. Negative balances amounting to P3.665 million for 92 SLs of ICR Active and Past Due accounts, as follows:

<b>Accounts</b>	<b>Negative Balances</b>	<b>No. of SLs</b>
ICR – Past Due	P 275,400	1
ICR	3,389,268.38	91
<b>P</b>	<b>3,664,668.38</b>	<b>92</b>

c. On the Past Due Loans accounts,

- i. Several Past Due Loans accounts totaling P1.730 million were not itemized and lodged under the description “various accounts”, thus, GL balance of these accounts could not easily be determined to ascertain the following balances:

<b>Particulars</b>	<b>Amount</b>
Past due commercial loan	P 40,486.52
Past due small business loan	351,312.57
Past due car loan	1,338,656.47
<b>P</b>	<b>1,730,455.56</b>

- ii. Past due accounts pertaining to salary and other loans totaling to P1.362 million have no schedule summarize as follows:

<b>Particulars</b>	<b>Amount</b>
Past due – salary loan	P 145,646.87
Past due other loan	1,216,873.74
<b>Total</b>	<b>P 1,362,520.61</b>

- iii. In the absence of schedules and aging of receivables the correctness and the reliability of allowance for doubtful accounts amounting to P210.391 million cannot be ascertained. Details as follow:

<b>Particulars</b>	<b>Amount</b>
Allowance for doubtful accounts –Other Loans	P (208,099,774.70)
Allowance for doubtful accounts –Other Loans	(2,290,764.23)
<b>Total</b>	<b>P (210,390,538.93)</b>

3.4 Based on the foregoing observations, the non-reconciliation of data and negative/abnormal items noted, cast doubt on the reliability and accuracy of the amounts as reflected in the financial statements contrary to the Conceptual Framework for Financial Reporting as stated in paragraph 3.1 hereof.

**3.5 We recommended that Management:**

- a. Include in the schedule of Investment in real estate controlling account of the CD the number of lots available for sale in square meters to support the balances booked under Investment in Real Estate and facilitate the reconciliation of the inventory list available for sale reported with PMD or AMD and at the same time come up with an updated COS;**
- b. Prioritize the preparation of SL schedules and aging for all accounts and reconcile the schedules and the balances of the accounts to come up with correct and reliable account balances;**
- c. Identify the cause of the negative/abnormal items in the SL including a review and analysis of the validity of the items; and**
- d. Make the necessary adjustments for fair presentation of the accounts in the financial statements.**

**3.6 Management commented that:**

- a. The CD and the AMD are maintaining their SLs for the ICR accounts. For the projects that are lodged in the Legacy System, the SLs are being shared by CD and AMD. The SLs are being updated by AMD once payments are made by the buyers. For the other projects, manual SLs are being maintained both by CD and AMD since the Lending Module crashed in February 2012. There are more than 1,000 manual SLs maintained by CD. The reconciliation of the Installment Contracts Receivables (ICRs) and the Buyers Deposits (BD) accounts are continuously being done and these are being reconciled also with the General Ledger balances. The reconciliation of the ICR account, however, was stopped since the assigned personnel resigned in August 2016. Some existing personnel of CD were tapped to update the schedule during overtime. CD will review the job assignments to identify the personnel who will handle the reconciliation and recommend hiring of additional employees, as necessary.
- b. In CY 2015 and CY 2016, CD made efforts to reconcile the ICR and BD accounts. The reconciliation resulted to the updating also of the individual SLs of the buyers. Several accounts with negative balances and with reciprocal accounts with those Past Due ICRs were resolved and were adjusted to their correct balances. The adjustments can be traced to the journal vouchers prepared by CD during the period. Most of the accounts with negative balances in the latest schedule of the ICRs are those accounts with excess payments. CD is not closing the accounts since the excess payments are for or may still be refunded to the buyers.
- c. The SLs for the joint venture projects, particularly the Mt. Zion and the Villa Caceres are still being coordinated with the joint venture (JV) partners. Continuous updating of the System's SLs are being done once references are made available by the JV partners.

d. CD maintains an investment schedule showing the book values and the remaining area for sale. A copy of which was already provided to the auditor. The remaining area in square meters are reflected in the sub-schedules and not in the controlling account. In order to reconcile the figures with the operating unit, CD has already requested the Property Management and Enhancement Department to validate the figures of the CD. The validated figures will be used as reference in the recomputation of the cost of sale, as necessary.

3.7 We acknowledge Management effort. Management should continuously analyze and reconcile individual ledger accounts with their controlling accounts for IRE, AA, ICR and Past due accounts to avoid further incurrence of negative balances. Likewise, the sub-schedule of Investment in real estate account indicating the remaining area in square meters should be updated to ascertain the veracity of recorded amount booked in the said account.

**4. Cash in Bank amounting to P8.956 million was not confirmed by the bank and cannot be accounted for as of December 31, 2016, contrary to Sections 63 and 74 of Presidential Decree (PD) No. 1445.**

4.1 Section 63 of PD No. 1445 on the accounting for moneys and property received by public officials provides that:

*“Accounting for moneys and property received by public officials. Except as may otherwise be specifically provided by law or competent authority all moneys and property officially received by a public officer in any capacity or upon any occasion must be accounted for as government funds and government property. Government property shall be taken up in the books of the agency concerned at acquisition cost or an appraised value.”*

4.2 Section 74 of the same PD states that:

*“Monthly reports of depositories to agency head. At the close of each month, depositories shall report to the agency head, in such form as he may direct, the condition of the agency account standing on their books. The head of the agency shall see to it that a reconciliation is made between the balance shown in the reports and the balance found in the books of the agency.”*

4.3 As at December 31, 2016, the System’s Cash and Cash Equivalent amounted to P588,833,933.64, of which Cash in Banks amounted to P59,226,374.29.

4.4 In CY 2016, the System closed its checking and savings accounts in a bank as partial compliance with our prior years’ audit recommendation.

4.5 Audit of the Cash in Bank accounts disclosed that the record per CD showed an outstanding balance of P8.956 million which pertains to the said closed bank account. The said amount represents reconciling items due to prior years’ non-preparation of bank reconciliation, details of which are as follows:

<b>Particulars</b>	<b>Account Code</b>		<b>Amount</b>
Cash in Bank – Savings Account	101127	P	78,441,442.32
Cash in Bank – Checking Account	101106		(69,485,347.30)
<b>Total</b>		<b>P</b>	<b>8,956,095.02</b>

4.6 Thus, the amount of P8.956 million, which was not confirmed by the bank, cannot be accounted for as of December 31, 2016 contrary to Sections 63 and 74 of PD No. 1445.

4.7 **We recommended that Management:**

- a. **Coordinate with the Bank for the reproduction of documents for the withdrawal of P8.956 million; and**
- b. **Require the responsible official to account for and produce the said amount and file appropriate charges in case of failure to do so.**

4.8 Management commented that the CD is exerting its best effort to finish the bank reconciliation for the subject bank account, which will be completed within the winding down period.

**5. The System's limited working capital of P888 million may result in its inability to refund in lump sum the total contributions including earned interest to the officer or enlisted personnel upon separation or retirement from military service under Section 4 of PD No. 361 as amended by PD Nos. 1656 and 1909 or upon liquidation of the System due to the issuance of MO No. 90 dated April 8, 2016 whichever comes first, since the related accumulated members' contributions payable as at December 31, 2016 amounted to P10.886 billion.**

5.1 Section 4 of PD No. 361 as amended by Section 1 of PD No. 1656 states that:

*“Officers and enlisted personnel in the active service of the AFP shall contribute monthly to the System an amount equivalent to five per cent (5%) of their monthly base pay, which contribution shall be deducted from their pay by the Armed Forces of the Philippines and paid to the System: Provided, that any officer or enlisted personnel who is separated or retired shall upon his separation or retirement be refunded in one lump sum all his contributions to the System: Provided, further, that such contributions shall be tax deductible for purposes of individual income tax return.”*

*While Section 2 of PD 1909 provides that:*

*“The System shall forthwith support the payment of the increment representing the difference between the existing pension rate and the adjusted pension rate computed on the basis of the prevailing scale of pay officers and enlisted men in the active service: Provided, that*

*payment thereof by the System and receipt of the adjusted pension shall be in accordance with the rate of pension and schedule of payment as shall be determined and fixed under the implementing rules and regulations promulgated by the Chief of Staff, Armed Forces of the Philippines, and approved by the Minister of National Defense: Provided, Further, that nothing herein shall be construed as authorizing payment of back pension prior to the promulgation of this Decree.”*

5.2 Working capital is a financial metric which represents operating liquidity available to a business, organization or other entity, including government entity. It measures both a company’s efficiency and its short term financial health. A company can be endowed with assets and profitability but short of liquidity if its asset cannot readily be converted into cash. Positive working capital is required to ensure that a company is able to continue its operation and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses.

5.3 Favorable key financial ratios are positive trends signifying stability. With three years comparison, the System is operating on a positive working capital, as its current assets exceeded its current liabilities as shown in the following table:

	2016	2015	2014
	(in million pesos)		
<b>Current Assets:</b>	<b>2,274</b>	<b>3,737</b>	<b>3,469</b>
Cash and cash equivalents	589	117	333
Short-term investments-net	755	2,821	2,512
Receivables – net	515	186	135
Current portions of loans receivable	383	593	465
Other current assets	32	20	24
<b>Current Liabilities:</b>	<b>1,386</b>	<b>1,203</b>	<b>1,317</b>
Notes payable	-	-	40
Accounts payable and accrued exp.	519	522	488
Members’ contributions payable	611	483	561
Current portion of estimated liability on earnings of MCs	256	198	228
<b>Working Capital</b>	<b>888</b>	<b>2,534</b>	<b>2,152</b>

5.4 The System posted a positive working capital since the bulk of its current assets pertain to short term investment. However, with the issuance of MO No. 90 by the President of the Philippines, dated April 8, 2016, directing the abolition of the System, there is a possibility that it may not be able to meet its maturing obligations such as the payment of refund of the System members’ contributions as they fall due inclusive of interest which may not be advantageous to its members contrary to Section 4 of PD No. 361 as amended by PD No. 1656 and 1909.

5.5 The System is now paying its members the refund of contribution plus interest earned averaging P212 million quarterly or an estimated P850 million a year. In addition, the members’ contribution payable composed of current and non-current amounted to P10.886 billion as compared to the limited working capital of P888 million as at December 31, 2016. Thus, the System may not be able to fulfill its mandate to the soldiers/members who are the real beneficiaries of the funds of the System.

5.6 **We recommended that Management:**

- a. **Continuously work towards conversion of the majority of the investments in real estate, acquired assets into cash and investments in government marketable securities which are easily convertible to cash; and**
- b. **Pursue collections of all indebtedness due to the System so that it can return to the soldiers/members their contributions upon liquidation of the System or upon retirement/separation whichever comes first.**

5.7 Management has not yet submitted their comments on above observations and recommendations as of this writing.

6. **In spite of the approval of the abolition of the System issued under Memorandum Order No. 90, there is a delay in the liquidation of the System in view of the absence of the approved Plan of Liquidation by all members of the Technical Working Group (TWG), contrary to the provision of Section 4.6 (f) of Governance Commission for GOCCs (GCG) Memorandum Circular No. 2015-03 and COA Circular No. 92-375. Thus, the objective of winding down for the period of three years may not be achieved.**

6.1 Section 4.6 (f) of GCG Memorandum Circular No. 2015-03 re: Guidelines covering the merger or abolition/dissolution of GOCCs, specifically provides:

*4.6 Matters to Be Resolved by the TWG on Abolition “The TWG shall resolve the following:*

*(a) to (f) x x x ;*

*(f) - the formal submission of the Plan of Liquidation of the GOCC which shall then be approved by all members of the TWG for implementation of the dissolved GOCC, Parent GOCC, or Supervising Agency, as the case may be;*

*(g) x x x.*

6.2 Sections 4, 5 and 6 of COA Circular No. 92-375, on the accounting guidelines and procedures for the closing of books of accounts of abolished/ transferred/merged/consolidated/converted/sub-divided agencies and the opening of books of accounts for agencies affected by such abolition/transfer/merger/ consolidation/conversion/ subdivision pursuant to provisions of law, provides the following:

**4.0 CUT-OFF DATE**

*The cut-off date to effect the transfer of balances of accounts from the old to the new agency is the effective date of abolition, transfer, merger, consolidation or sub-division pursuant to the provisions of law. However, for purposes of reconciliation, consolidation, adjustment, closing of books*

*of accounts of the old agency and opening of books of accounts of the new agency, a maximum of six (6) months transitory period from the cut-off date shall be allowed to effect such transfer.*

## **5.0 GENERAL GUIDELINES**

*5.1 The books of accounts of the old agency shall be closed as of the cut-off date and the balances of all existing assets, liabilities, and surplus/capital shall be transferred to the new agency/agencies.*

## **6.0 INTERIM PROVISIONS**

*In the meantime that the abolition/merger/transfer/consolidation/conversion/ subdivision has not been fully effected, the "old" and the new" agencies shall ensure that the following are complied with:*

*6.1 The heads of the old and the new agencies shall require existing personnel to analyze, reconcile and effect the transfer of accounts as provided herein.*

6.3 MO No. 90 provides the creation of a TWG to assist the GCG in the privatization of the System's subsidiaries, the winding down and liquidation and the payment of the separation pay of affected personnel. However, despite the issuance of the said Memorandum, the deactivation, the winding down and liquidation of the System were not yet fully implemented.

6.4 In compliance with the above Memorandum, the System has already ceased collecting members' contributions and accrual of interest thereon effective March 31, 2016 and continues to refund of the System members' contributions as they fall due.

6.5 The following were noted in connection with the abolition of the System:

- a) The System's BOT was already converted into the BOL effective April 19, 2016 as provided for in MO 90. The winding down plan of the System was already approved by the BOL on September 22, 2016 and was transmitted for approval to the GCG-TWG on October 4, 2016. However as of to date, there is no approved Plan of Liquidation from the TWG constituted to take charge of the abolition;
- b) The objective and strategies laid down in the System's winding down plan to effect the timeline for the period of three years may not be achieved due to the said absence of the approved plan;
- c) Likewise, the closing and transfer of the books of accounts could not be effected despite the issuance of MO 90.

6.6 Due to the pending approval of the Plan of Liquidation of the System from all the members of the TWG, the implementation of MO 90 may cause delay in the liquidation of the System and defeat the purpose of COA Circular No. 92-375 mentioned in paragraph 6.2 hereof.

**6.7 We recommended that Management:**

- a. Continuously coordinate with the TWG to facilitate the abolition of the System and adhere to existing guidelines in the closing and transfer of books of accounts; and**
- b. Make representation with the TWG constituted to take charge in the abolition of the System.**

6.8 Management commented that while waiting for the approval from the GCG, the System undertook liquidation efforts. The sale of real estate inventories which does not require public bidding was aggressive. On the other hand, pending formal approval of the Winding Down Plan, the System already sought approval from the BOL of Terms of Reference (TOR) of several assets to be sold via public bidding and constituted the Disposal and Bidding Committees as stated in the submitted Winding Down Plan. However, the Management and the BOL are holding the conduct of public bidding pending approval of the GCG of the System's Winding Down Plan.

6.9 The GCG TWG for Memorandum Order 90, composed of representatives from DND, DOF, DBM, PMO and the System, convened last February 27, 2017. The GCG requested submission of several reports from the System in order for them to fully evaluate and approve the Winding Down Plan. Last March 8, 2017, the System submitted to GCG the required reports/references. As of the moment, the System is still awaiting GCG approval of the Winding Down Plan submitted last October 4, 2016.

**7. The fixed monthly representation allowance received by the Board of Trustees (BOT) amounting to P441,000 did not conform to the pertinent provisions of Executive Order (EO) No. 24 and COA Circular No. 2012-001.**

7.1 Our audit of the Representation Allowance of the Board of Trustees is guided by the following rules and regulations:

- a. EO No. 24, s. 2011 prescribes the rules to govern the compensation of members of the Board of Directors/Trustees in government-owned or controlled corporations including government financial institutions, as follows:

*Section 12. Reimbursable Expense –*

*All necessary expenses of members of the Board of Directors/Trustees to attend Board and other meetings and discharge their official duties shall be paid directly by the GOCC. However, when due only to the exigency of the service and subject to the submission of receipts, it is necessary for the members of the Board of Directors/Trustees to advance the same, they may be reimbursed but only for the following items incurred in the performance of official functions subject to budgeting, accounting, and auditing rules and regulation:*



- a) *Transportation expenses in going to and from the place of meetings;*
- b) *Travel expenses during official travel;*
- c) *Communication expenses; and*
- d) *Meals during business meetings.*

**Section 13. Compliance –**

- a) *The board of directors/trustees of all chartered GOCCs, whether or not covered by the salary standardization law, are hereby directed to comply with the provisions contained in the EO to govern the compensation and reimbursable expenses of the members of the board of directors/trustees in their respective corporations; and*
- b) *The board of directors/trustees of all non-charted GOCCs, including all subsidiaries, are hereby directed to pass board resolutions adopting or reiterating the provisions contained in this EO to govern the compensation and reimbursable expenses of the members of the board of directors/trustees in their respective corporations."*

*Section 15. Restitution – Upon the determination and report of the Commission on Audit (COA) that a member of the Board of Directors/Trustees has received any amount or property beyond what is allowed in this Executive Order or has received anything which accrues to the GOCC represented by him/her, the member of the Board of Directors/Trustees shall immediately return the same to the GOCC concerned.*

b. *COA Circular No. 2012-001 dated June 14, 2012 enumerated the documentary requirements for common government transactions and one of the general requirements for all types of disbursements is "sufficient and relevant documents to establish validity of claims."*

**7.2 Our audit revealed the following:**

- a. The members of the BOT were granted a fixed monthly representation allowance of P7,000 each. For CY 2016, they have received a total of P441,000 which were also reported in the quarterly report on salaries and allowances (ROSA). As of audit date, we also noted that there are still several unreleased checks totalling P133,000;
- b. Granting that the representation allowance was paid on a reimbursable basis, verification of the disbursement vouchers showed no documentary attachments to support the claims relative to meetings held. Neither was there proof showing that the expenses were incurred in the performance of official functions as required under COA Circular No. 2012-001 which generally requires "sufficient and relevant documents to establish validity of claim."; and
- c. To date, the audit team was not provided with the legal basis for the granting of the monthly representation allowance. Our team requested the

System to stop the granting of representation allowance unless substantiated by either the legal basis for the granting thereof or the submission of receipts and other documents to support the claim. Accordingly, the unreleased checks are still with the Treasury Department as of December 31, 2016.

7.3 As provided in Section 12 of EO No. 24, the BOT are entitled to reimbursable expenses and not representation allowance, in the exigency of the service and subject to the submission of receipts. Full documentation is required to establish the propriety of the expenses.

7.4 In view of the above observations, the validity and propriety of the expenses incurred could not be established contrary to the pertinent provisions of EO No. 24 and COA Circular No. 2012-1.

7.5 **We recommended that Management:**

- a. **Discontinue granting representation allowance to the members of the BOT which is contrary to EO No. 24;**
- b. **Require the refund of representation allowance received by the members of the Board in excess of what is allowed under EO No. 24;**
- c. **Secure approval from the Office of the President for the grant of benefits in addition to per diems to the members of the BOT now BOL;**
- d. **Cancel the unreleased checks in the total amount of P133,000; and**
- e. **Faithfully comply with the mandate and guidelines of EO No. 24.**

7.6 Management commented that the System has already stopped the granting of representation allowance to the members of the BOL since August 2016. This allowance is being given to the Trustees for the expenses they incurred in the performance of their duties such as expenses in conducting research and studies of the different business proposals being presented to the Board for consideration and approval. The vouchers for the allowances for the months of August and September 2016 were processed but were not released to the members of the BOL. For the representation allowances that were granted from January to July 2016 that are being required by COA to be refunded, the same will be discussed during the meeting of the BOL since the members are the ones affected by the COA observation. The System will take appropriate action on the unreleased checks after the discussion of the matter with the BOL.

7.7 For the additional benefits that will be granted to the BOL in addition to the per diems, the same will be discussed also during the BOL meeting subject to compliance to Section 13.b of EO No. 24 and henceforth will see to it that the System will always comply with the mandate and guidelines of EO No. 24.

**8. OGCC lawyers were paid Representation and Transportation Allowance in the total amount of P876,000 in the guise of fixed monthly compensation/out-of-pocket expenses contrary to Item No. 4 of National Compensation Circular (NCC)**

**No. 67 dated January 1, 1992, thus, considered irregular expenditures under COA Circular 2012-003. Nine of these lawyers were paid allowances even if they were not assigned/designated to perform additional or special tasks in the System contrary to Section 6 of Executive Order (EO) No. 878.**

8.1 Item No. 4 of National Compensation Circular (NCC) No. 67, dated January 1, 1992 provides that “No one shall be allowed to collect RATA from more than one source.”

8.2 Section 3 of COA Circular 2012-2003 which provides that expenditure incurred without adhering to established rules, regulations, procedural guidelines, policies, principles or practices that have gained recognition in laws are considered Irregular Expenditures.

8.3 Section 6 of EO No. 878 provides that:

*“When the exigency of the service so requires, any member of the legal staff of the OGCC may be assigned or designated in a concurrent capacity to act as corporate officer of the government-owned and controlled corporations being serviced by the OGCC, provided that the OGCC approves the assignment or designation. Whenever any member to perform additional or special task in any of the client corporations, he is allowed to receive such additional compensation and privileges as may be granted them by the government corporations concerned.”*  
(Underscoring Supplied)

8.4 Section 1 of Memorandum of Agreement (MOA) between the System and OGCC dated March 17, 2010 provides that OGCC shall render legal services to the System, as follows:

- a. *To personally represent the System in major/important legal cases, whether filed for or against the System;*
- b. *To prepare and review contracts entered into or proposed to be entered into by the System;*
- c. *To act as Hearing Officers and/or Prosecutors in Administrative hearings;*
- d. *To provide the System with legal advice and analysis of the legal and corporate implications of various plans and strategies to be adopted in pursuing the acquisition of the right of way;*
- e. *To assist the System during meetings with Local Government Officials regarding various issues affecting the administrative, regulatory and property relations with the local government officials concerned;*
- f. *To render financial advisory services or opinions on questions or issues, necessary to inform the System in making a decision,*

*involving a policy or to guide the corporation in taking the appropriate action with respect to important matters or issues, and to render other special and miscellaneous legal services of the System that may need or will require.*

8.5 Accounting records show that in addition to Special Counsel Allowance (SCA), OGCC lawyers are receiving additional allowances in the performance of their duties. These allowances are the following:

- a. *Representation allowance* – this allowance represents reimbursable meal expenses incurred during court attendance.
- b. *Travel lodging allowance* - reimbursable hotel accommodation and lodging costs incurred in the performance of assigned tasks when the necessity arises.
- c. *Travel/transportation allowance* - this includes roundtrip airfare and ferry tickets, taxi fare and toll fees, terminal fees and parking fees. Also, OGCC lawyers are granted reimbursable gasoline allowance in case the System fails to provide transportation vehicle to enable the OGCC lawyers to go to the place of meeting or court hearing.
- d. *Compensation/Out-of-pocket Expense* – This represents extended monthly reimbursable allowance payable to the account of the OGCC lawyer.

8.6 We noted in our audit that payments to OGCC lawyers for CY 2016 pertaining to compensation/out of pocket expense amounting to P876,000 were made on top of the SCA and reimbursable allowances.

8.7 Our audit also revealed the following:

- a. The Compensation/out-of-pocket expenses in the amount of P876,000 is recorded in the book as debit to travel/transportation account. Inquiry with the CD disclosed that the nature of the allowance is similar to Transportation Allowance.
- b. Check Vouchers were not supported with official receipts and other documents which may prove that actual travels and representations have been made.
- c. Certification issued by the OGCC was attached certifying that the claim is for reimbursement of necessary transportation and representation expenses incurred by respective OGCC lawyer in rendering special legal services. Confirmation revealed that they were already paid representation and transportation allowances by their mother agency, the OGCC for the same period.

8.8 We requested the submission of office orders assigning and/or authorizing the above OGCC lawyers to perform additional or special task in the System as required under Section 6 of E.O. No 878. However, as of audit date, the Office Orders presented pertains only to four OGCC lawyers while the Office Orders of the other nine lawyers are

dated only on March 3, 2017. The services rendered by the OGCC lawyers for the System were considered their mandated and/or regular functions thus, they are not entitled to receive additional compensation because the third condition that OGCC lawyer is assigned / designated to perform additional or special task was not met. Likewise, the grant of additional compensation in the form of RATA to OGCC lawyers rendering legal assistance to GOCC without the presence of the following three conditions required under Section 6 of EO No. 878 is considered irregular expenditures.

- a. That the exigency of the service so requires;
- b. That the GCC approves the assignment or designation; and
- c. That the OGCC lawyer is assigned/designated to perform additional or special task in any of the client corporation.

8.9 The pertinent provision of NCC No. 67 read:

*In all cases, commutable and reimbursable RATA shall be paid from the amount appropriated for the purpose and other personal services of the agency or project from where the officials and employees covered under this Circular draw their salaries. No one shall be allowed to collect RATA from more than one source. (Italics supplied)*

8.10 Accordingly, the NCC No. 67 seeks to prevent the dual collections of RATA by a public official from the budgets of more than one agency. We emphasize that the other source referred to in the prohibition is another agency. Clearly therefore, the prohibition in NCC No. 67 is only against the dual or multiple collection of RATA by a public official from the budgets of two or more national agencies. Stated otherwise, when a national official is on detail with another national agency, he should get his RATA only from his mother agency and not from the agency he is detailed to.

8.11 Consequently, the receipt of such allowance in the form of compensation/out-of-pocket expense claimed as RATA is tantamount to additional or double compensation governing public officials and employees which is contrary to Section 8, Article IX-B of the 1987 Constitution, providing for the Rule Against Additional or Double Compensation for Public Officials and Employees which states that:

*“No elective or appointive public officer or employee shall receive additional, double, or indirect compensation, unless specifically authorized by law, nor accept without the consent of the Congress, any present, emolument, office, or title of any kind from any foreign government.”*

8.12 **We recommended that Management:**

- a. **Strictly adhere to the provision of Section 6 of EO No. 878 and discontinue the granting of fixed monthly allowance to OGCC lawyers;**
- b. **Require the concerned OGCC lawyers who are receiving RATA from the System to refund the amount of P876,000 corresponding to an additional compensation; and**

**c. Abide by the guidelines set forth under COA Circular 2012-003 to prevent irregular, unnecessary, extravagant and excessive use of government funds to avoid audit disallowances.**

8.13 Management commented that the OGCC is the principal and statutory law office/counsel of the System. As principal law office and as supervisor, it exercises control and supervision over the legal departments of GOCCs and have the following powers and duties:

- a. Represent GOCCs in the litigation of appropriate cases brought before the courts or quasi-judicial bodies in the Philippines or abroad in accordance with Rule 5 of these rules;
- b. Review and if necessary, recommend revisions or modifications on contracts referred by GOCCs as required by law, and/or prepare such contracts when so requested in appropriate cases in accordance with Rule 6 of these rules; and
- c. Render legal opinions, as required by law, on all important legal questions referred by the GOCCs conformably with Rule 6 of these rules.

8.14 On March 17, 2010, the OGCC and the System executed a Memorandum of Agreement (MOA) duly signed by then President of the System, and the then Head of OGCC. Pursuant to Section 2 of the said MOA, the System shall extend monthly allowance to the team of OGCC lawyers who are assigned to the corporation by the Government Corporate Counsel, in the total amount not exceeding P74,000, payable to the account of said lawyers, the breakdown of the allowances as well as the original OGCC lawyers assigned to the team is contained in "Annex A" of the MOA. All those OGCC lawyers that were given allowances are assigned to the team that handles cases involving the System and renders opinions on matters referred to by the System. It is OGCC that provides the System, in writing, of names of the lawyers who are assigned to the team and entitled to the said allowance.

8.15 Considering that the number of the in-house counsels of the System was substantially reduced from more than ten to just two at present including the Head who is also holding other concurrent positions (Head, Corporate Services Group; Head, Legal; Corporate Secretary; Compliance Officer to the GCG; BAC member), significant numbers of litigation cases and requests for opinions were regularly being referred to OGCC.

8.16 Inasmuch that OGCC is the principal and statutory lawyer counsel of the System and the MOA was prepared and signed by the Head of OGCC, we are of the honest belief that there is nothing irregular in giving such allowance.

8.17 In view of the fact that the AOM pertains to the allowance of OGCC lawyers, the AOM was immediately referred to OGCC for comments. To date, however, the System is still awaiting for the comments of the said office.

8.18 By way of an audit rejoinder, we emphasize that the OGCC lawyers are already receiving RATA in their mother agency which is the OGCC. Our verification disclosed

that expenses incurred by these lawyers in the conduct of their duty are reimbursed by the System on top of the fixed monthly compensation they are receiving as provided in the said MOA.

8.19 Aforesaid considered, we stand in our position and maintain our recommendation to the Management.

**9. Proceeds from the sale of bid documents in the conduct of public bidding were not recorded as trust receipts and were not monitored as basis for the payment of honoraria contrary to DBM Budget Circular (BC) Nos. 2007-3 and 2004-5A, thus, resulted to overpayment by P175,500.**

9.1 DBM BC No. 2007-3 dated 9 November 2007 amended item no. 6.1 of DBM BC No. 2004-5A dated October 7, 2005, among others, which identified additional funding source for payment of honoraria for chairs and members of the Bids and Awards Committee (BAC) and the TWG and overtime pay for administrative staff supporting the BAC and TWG. In the case of GOCCs, the savings from the DBM-approved corporate operating budget (COB) will be the additional source for the payment of honoraria and overtime pay.

9.2 On the other hand, Sections 6.1 and 6.2 of DBM BC No. 2004-5A provides that:

*“6.1 The amount necessary for the payment of the honoraria and overtime pay authorized herein shall be sourced only from the following:*

- *Proceeds from sale of bid documents;*
- *Fees from contractor/supplier registry;*
- *Fees charged for copies of minutes of bid openings, BAC resolutions and other BAC documents;*
- *Protest fees;*
- *Liquidated damages; and*
- *Proceeds from bid/performance security forfeiture.*

*6.2 Pursuant to the DOF-DBM-COA Permanent Committee Resolution No. 2005-2 dated June 2005, all agencies are authorized to treat the collections from the sources identified in item 6.1 hereof as trust receipts to be used exclusively for the payment of honoraria and overtime pay herein authorized. Agencies may utilized up to one hundred percent (100%) of the said collections for the payment of honoraria and overtime pay subject to the guidelines in item 5.0 of this Circular. In case of GOCCs and LGUs, the same shall form part of their corporate or local government funds, respectively”*

9.3 Items 6.3 and 6.4 of the same Circular states that the total amount of honoraria and overtime pay to be paid for the procurement related activities shall not exceed the said collections and in cases of deficiency from collections, the amount of honoraria and overtime pay shall be adjusted proportionately for all those entitled thereto.

9.4 In CY 2016, the System awarded eight procurement contracts attributable to Janitorial and Messengerial Services, Repair and Maintenance and Security Services for several investment projects of the System. Accordingly, proceeds from the sale of bid documents for a particular project/s or procurement of goods and services were collected by the Treasury Department.

9.5 As of December 31, 2016, the amount eligible for honoraria distributions includes collections from the sale of bid documents only. The table below shows the overpayment of honoraria amounting to P175,500 compared to what is only due for distributions:

Month	Proceeds from sale of bid documents	Honoraria distributed	(Over) Under payment of Honoraria
January	20,000	-	-
February	-	28,500	(8,500)
March	-	-	-
April	50,000	-	-
May	-	64,000	(14,000)
June	-	126,000	(126,000)
July	-	-	-
August	-	-	-
September	15,000	-	-
October	20,000	-	-
November	-	-	-
December	-	62,000	(27,000)
<b>TOTAL</b>	<b>105,000</b>	<b>280,500</b>	<b>(175,500)</b>

9.6 Verification of accounting records revealed that the amount earned from the sale of bid documents for CY 2016 were recorded as credit to Miscellaneous Income account, mixed with other income for the period, which were subsequently closed to Retained Earnings. Also, BAC honoraria are included in the computation and payment of payroll, thus, the tendency of overpayment due to non-monitoring of amount eligible for the distribution of honoraria is highly probable because payment of payroll is deducted directly from the corporate fund.

9.7 There is no dispute that the members of the BAC, TWG and BAC Secretariat shall be paid honoraria for the services rendered. However, the payment of honoraria is subject to the availability of funds and shall follow the guidelines and relevant rules which are promulgated by the DBM. We emphasize further that any unutilized proceeds for a given year shall not be carried over to the succeeding year in order to have funds available for distributions, instead it should be reverted to the corporate fund at the end of the year, thus honoraria distributions shall be based only on the income/collections from the conduct of public bidding for the given year.

9.8 Foregoing considered, the non-monitoring of collections/proceeds from the sale of bid documents and other income from the conduct of public bidding is contrary to the above quoted DBM Budget Circulars which resulted in the overpayment of honoraria by P175,500.



**9.9 We recommended that Management:**

**a. Properly record the proceeds earned from the conduct of bidding as trust receipts and strictly monitor such collections as basis for the payment of honoraria in accordance with the provisions of DBM Budget Circular Nos. 2007-03 and 2004-5A; and**

**b. Refund the excess payment of honoraria amounting to P175,500 from the concerned members of the BAC, TWG and BAC Secretariat.**

9.10 Management commented that Item 3.1.3 of DBM BC No. 2007-3 provides that in the case of GOCCs, savings from the DBM-approved COB can be a source of honoraria and further stated that 3.2.1 provides that savings still available after the completion or final discontinuance or abandonment of the work, activity or purpose for which the appropriation is authorized.

9.11 They further stated that since the System has been issued MO No. 90 for its abolition and winding down in CY 2016, this compels them to cut out costs, the nature of which can be considered as savings that can be certified the Controllership Department.

9.12 They also stated that the GCG has excluded employees of the System from receiving other benefits to include Performance Based Incentive and Performance Based Bonus even though the organization still exist and their officers and employees are still able and willing to work to fulfill their mandate of liquidating the assets of the System thus is requesting COA to reconsider its position on the honoraria of the BAC members as they are deemed legally and morally entitled to the same, thus, not an irregular expenditure that would require refund.

9.13 By way of an audit rejoinder, there is no dispute that personnel involved in procurement activities beyond their regular functions are entitled to receive honoraria. However, the source of funding shall also be taken into consideration.

9.14 In view of Management's reply on the System's savings deem as eligible for distribution of Honoraria, the reasonableness of the Approved Budget of Contract (ABC) shall be reconsidered to come up with an economical contract price. Further, we noted that the System has no DBM-approved COB for CY 2016 which is required under paragraph 3.1.3 of DBM Circular No. 2007-003 dated November 29, 2007 for the Agency to use savings for the payment of honoraria.

9.15 Aforesaid considered, we stand in our position and maintain our recommendation to the management for the refund of the excess amount of P175,500.

**10. The development of a 571,479 sq. m lot to a Residential Subdivision project was not completed in accordance with the Joint Venture Agreement (JVA), although the shares in the property were already titled in the name of the Developer. The abrogation of JVA as approved by the BOT was not implemented, thus, the property remains undeveloped and idle, which may adversely affect the sale of all the System's real estate in line with its winding down activities.**

10.1 On April 11, 2003, System entered into a JVA with a Developer to develop into a low-cost to medium cost residential subdivision, now identified and known as Benjamin 9 Northville Subdivision, a parcel of land in Pandacaqui, Mexico, Pampanga containing an area of 571,479 square meters covered by TCT No. 509405-R.

10.2 Under the JVA, the Developer has the full authority to develop and subdivide the property into a subdivision project subject to the terms and conditions specified therein. The developer in consultation with the Owner may increase or decrease the area covered by each phase and may accelerate but not delay the scheduled development thereon. The time frames/periods for the development works are shown on the table below:

Phase	Area (hectares)	Period
Phase I	20	2003-2006
Phase II	11	2006-2008
Phase III	9	2008-2009
Phase IV	17	2009-2010

10.3 The JVA also provides that the Developer shall subdivide and secure the individual titles to and tax declarations for each lot. For and in consideration of the obligations and undertakings, the Developer shall be entitled to 55 per cent of the net saleable area of the developed property while the System shall be entitled to 45 per cent. Thereafter, each party shall be responsible for the payment of the realty taxes on the subdivided lots allocated to each in accordance with the sharing as indicated in the Deed of Partition.

10.4 Review of the accounting records disclosed that the System's entitlement to 45 per cent of the net saleable area of the developed property was booked under Investment in RE-Landbanking with a balance of P122.545 million as at December 31, 2016.

10.5 Inspection of the property and its corresponding deliverables, however, revealed that the schedule development works, as agreed upon in the JVA, was not complied with, as the roads connecting each phase was partially constructed indicating that the construction phase was unfinished. The Management Disposition Form dated February 11, 2008 revealed that only Phase 1A which represents 37.65 per cent representing 1,516 saleable lots containing an area of 135,332 sq. meters with the resultant lots divided proportionately had been accomplished when the Developer stopped the construction as of April 30, 2008.

10.6 The BOT in its minutes of the meeting dated March 17, 2014 approved the formal termination of the JVA with the Developer for the development of the System's property in Mexico, Pampanga, however, as of audit date, negotiation with the Developer for the mutual rescission of the JVA remained unacted upon which may affect the sale of all its real estate in line with the winding down activities.

**10.7 We recommended that Management implement the abrogation of the JVA as approved by the BOT or consider filing an action for damages against the Developer for breach of contract.**

10.8 Management commented the following:

- a. Per Board approval sheet dated 31 March 2014, the partial abrogation of the JV has been approved after the Developer informed the System of its lack of funds as borne by the letters sent to the System by the former dated 15 November 2012 and 22 January 2014.
- b. The Developer was officially notified of the abrogation, however, subject company has been continuously negotiating with the System for it to either buy-out the System or offer the System's share to a third party.
- c. In connection with the COAs recommendation, Management shall again communicate with the Developer to officially terminate the JV. For information, however, the undeveloped portion of the project (Phases 2-4) is actually programmed for disposal within the first year after GCGs approval of their winding down plan.

10.9 By way of rejoinder, Management should further hasten the foregoing planned mutual abrogation with the developer and come up with the agreed terms and conditions at the most advantageous to the System, otherwise, file a case against them in order to obligate the Developer to transfer the remaining 658 TCTs registered under their name comprising of 109,653 sq.m.

**11. Lapses in the maintenance and management of properties expose the System to risk of loss and incurrence of additional monetary burden.**

11.1 Internal control is a systematic measure (such as reviews, checks and balances, methods and procedures) instituted by an organization to: (1) conduct its business in an orderly and efficient manner, (2) safeguard its assets and resources, (3) deter and detect errors, fraud, and theft, (4) ensure accuracy and completeness of its accounting data, (5) produce reliable and timely financial and management information, and (6) ensure adherence to its policies and plans.

11.2 As at December 31, 2016, the total Investment in RE of the System is P6.442 billion representing 40 per cent of its total assets of P16.550 billion. The System has 30 projects under Investment in RE account grouped in eight classification as follows:

Classification	No. of Projects
On Base Housing Project	1
Off base Housing Project	1
Memorial Park	2
Residential Subdivision	11
Commercial Subdivision	4
Golf Course	2
Sports and Country Club	1
Landbanking	8
	<b>30</b>

11.3 Ocular inspections were conducted on nine accounts under Investment in RE and one account booked under Acquired Assets (AA) with net carrying values of P1.796 billion or 27 per cent of the said total Investment and P2.665 million, respectively. Four accounts revealed the following lapses in the maintenance and management of properties:

**a. Maintenance programs and procedures to preserve or enhance the value of acquired assets at the Global Tower, Makati City, were not implemented resulting in rapid deterioration of the property.**

i. Verification disclosed that the System has two residential/office condominium units and five parking slots located at Global Tower Capt. Reyes Bangkal, Makati City, booked under AA. One unit and all parking slots were covered by lease contracts while Unit 1505 is vacant. On-site inspection revealed that the vacant condominium unit was in poor condition as evidenced by dilapidated ceiling, dislocated cabinet doors, unserviceable faucet, and cracked window. Likewise, an underground spring at the basement level makes it susceptible to frequent flooding, hence, the building management installed a motor pump to drain the continuous flow of water in the parking slots identified as 3BLs-34 to 36 and 3BLs-39 to 40. At the time of inspection, the parking slots were not available for use. There is no indication that Management took actions to restore or repair the vacant unit and parking slots to make it marketable.

ii. Moreover, there was neither “For Sale” nor “For Lease” signage posted within the vicinity to show that the units are offered for sale or for lease.

iii. The continuous deterioration of the asset due to the inability of the System to preserve or enhance the value of the acquired assets at the Global Tower, Makati City hinder its disposal which may result in the non-recovery of investment.

**b. Legal issues on ownership were noted over 61,159 sq. m. land of the San Mateo housing Project, thus, placing the System at the risk of losing the property.**

i. The System is the registered owner of a parcel of land located in San Mateo Rizal identified as Lot 15-A-1 with an area of 300,756 sq. m. under TCT No. 217070 derived from OCT No. 1275 issued on December 16, 1964 which was subsequently sold to Developer 1 who alleged that Developer 2 encroached on about 61,159 sq. m. of the subject parcel of land (“the contested land”). Developer 2 is claiming ownership of the contested land based on a TCT that was derived from an OCT dated October 14, 1929 which was clearly issued ahead of the OCT from where the title of the System emanated. Thus, Developer 1 paid only P38.319 million instead of the original contract price of P48.120 million exclusive of the 61,159 sq. m. contested lot, thereby, the System lost the amount of P9.801 million.

ii. Various issues relative to the San Mateo Housing Project were observed such as: (1) property located at Lot 10 Blk 2 covered by TCT N-116256 is not in the same location indicated in the vicinity map held by the System; (2) loan folder of a borrower is not on file thus the validity of the loan cannot be ascertained. According to the AMD personnel, such missing folder has been non-existent since they assumed Office; and (3) Three loan accounts covered by TCTs under the name of individuals were fully paid per AMD record but are still included in the inventory list of lots per PMD.

iii. The System failed to observe the required diligence in safeguarding the relevant document indicative of its failure to monitor and update its records.

**c. Other observations related to Investment in Real Estate – Landbanking accounts during inspection and examination of documents have titling and documentation issues as follows:**

***EGCS II - Landbanking***

i. The System acquired undeveloped raw lands from a JV Partner thru dacion en pago by way of a Deed of Assignment. Included in the System's list of assigned property is TCT# 5784 acquired by the said JV Partner from the original owner through a Deed of Absolute Sale (DAS) which is not notarized. Thus, the title still remains in the name of the original owner and cannot be transferred to the System.

ii. There are no caretakers and security guards for the property encompassing the EGCS II account with a total carrying value of P105.356 million covering 58 TCTs to secure them from illegal settlers. There were also no land markings installed by Management to identify the extent of the area. Said TCTs are still not titled to the System but instead seven are still in the name of JV partner, while 51 titles are still registered under the name of the original owners.

***Calamba, Tanauan***

i. Thirty one consolidated TCTs with a total land area of 272,929 sq. m. in Brgy Laurel Tanauan, Batangas are awaiting Department of Agrarian Reform (DAR) order of exemption. On the other hand, the acquisition of six agricultural land still registered under the name of previous owner were supported by un-notarized DAS. Thus, said property cannot be registered with the Register of Deeds.

ii. Ocular inspection of the above subject lands revealed that Management did not consider the topographical location in acquiring the various lands as some were located in a strongly sloping hill to mountainous landscape susceptible to soil erosion due to steep slope. Another instance, is the lot in Brgy Malaking Pulo, covered with TCT 65970 containing an area of 14,686 sq.m., triangular in shape in the nearby National Housing

Authority - housing project, since the lot has no fence, this could expose the said property to encroachment easily by the NHA residents.

iii. Also, the real property taxes on the above mentioned properties were not updated exposing the System to additional interest and penalties, hence disadvantageous to the System.

iv. Evidently, the failure to exercise diligence in the acquisition of these lots by the System will result in the delay of the realization of assets and concomitant loss to the System.

**11.4 We recommended that Management require the concerned department/division in pursuance to the winding down activities to:**

**a. Implement the maintenance programs and procedures to secure, preserve and enhance the value of acquired assets and prevent the rapid deterioration of the Acquired Asset and Investment in Real Estate properties; and**

**b. Resolve the legal and documentation issues relative to Investment in Real Estate accounts to protect the rights and ownership of the System over the subject property.**

**11.5 Management commented as follows:**

**a. On San Mateo Housing project**

PMED shall endeavor to secure certified copies of the OCT and the Decree from which Developer 2 derived its title to validate the title. Thereafter, request for recovery of the property through court action may be sought if the OCT/Decree will be found spurious.

As a rejoinder, if the System found out that the title of Developer 2 is not spurious, appropriate charges shall be filed against those persons who approved the acquisition of the property.

**b. On Investment in Real Estate – Landbanking accounts:**

For information, real estate tax for subject properties are updated and paid for the whole year of 2017. Further, management commented on the following accounts as follows:

- Calamba, Tanauan

Out of the 31 lots mentioned, 23 lots have been issued Order of Exemption with an aggregate area of 18.5569 has and the remaining eight lots have been denied exemption due to below 18 per cent slope. This was embodied in the DAR Order of Exemption dated 21 June 2016: Motion for Reconsideration re: Application for Exemption/Exclusion from CARP Coverage Pursuant to Section 10 of R.A. No. 6657 as Implemented under DAR Administrative Order No. 13 Series of 1990

Involving Parcels of Land located at Tanauan City, Batangas. For the 6 lots still registered in the name of the previous owner, there is a need to secure DAR clearance prior to title transfer in RSBS name. Once the DAR clearance has been secured, PMED will pursue the re-documentation of the Deed of Absolute Sale since the un-notarized DAS cannot be used for the registration in the Registry of Deeds. Currently, PMED has already secured the government certifications needed to apply for conversion, however, recently, the Department of Agriculture (DA) issued a two year moratorium on the application for conversion and for information, real estate tax for subject properties are updated ad paid for the whole year of 2017

As a rejoinder, we further wish to emphasize the importance of updating regularly the inventory schedule of TCTs. Additional information should also be provided in the inventory listing by providing columns intended for tax declaration, real property taxes paid and the period of coverage for proper monitoring and filing purposes.

## 12. Status of Suspensions, Disallowances and Charges

12.1 As at year-end, the status of audit suspension, disallowances and charges issued is as follows:

<b>Audit Action</b>	<b>Beginning Balance 01/01/2016</b>	<b>Issued</b>	<b>Settled</b>	<b>Ending Balance 12/31/2016</b>
Suspensions	-	-	-	-
Disallowances	250,318,200.00	1,254,276.74	4,770.00	251,567,706.74
Charges	16,270,683.00	-	-	16,270,683.00
<b>Total</b>	<b>266,588,883.00</b>	<b>1,254,276.74</b>	<b>4,770.00</b>	<b>267,838,389.74</b>

12.2 The Notice of Disallowance on the overpriced land acquisition by the System in the amount of P250.318 million and the corresponding Notice of Charge on the deficiency taxes on the overpriced land amounting to P16.271 million were affirmed by the Commission Proper under COA Decision Nos. 2012-139 and 2012-188 dated September 13, 2012 and November 5, 2012, respectively. Moreover, the Motion for Reconsideration filed by the System on the COA Decisions was denied under CP *En Banc* Resolution dated February 27, 2015. Accordingly, a Notice of Finality of Decision and COA Order of Execution were issued.

12.3 Furthermore, the Supreme Court promulgated its Decision under GR No. 217948 dated January 12, 2016 on the Petition for Certiorari for the notice of disallowance on the overpriced land acquisition affirming COA Decision No. 2012-188 dated November 5, 2012.

12.4 The System draw a Journal Voucher setting up the receivable from the person liable amounting to P250,318,200 on December 31, 2016.

12.5 Appeal memoranda were filed by the System on the disallowances issued in CY 2016 in the total amount of P1.250 million.