OBSERVATIONS AND RECOMMENDATIONS

A. Financial Statements

Intragroup balances of receivables and payables of LBP parent and subsidiaries

1. The absence of periodic reconciliation between the records of LBP and its subsidiaries caused the unreconciled differences on the balances of receivables and payables accounts in LBP's books with that of subsidiaries by approximately P81.821 million and P394.997 million, respectively, as at December 31, 2016.

1.1 Application Guidance of Philippine Financial Reporting Standard (PFRS) 10 provides that:

"B86. Consolidated financial statements:

(a) xxxx
(b) xxxx
(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profit or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). X x x x x."

1.2 The financial statements of LBP and its four subsidiaries are being consolidated in which the balance of each account of LBP and that of four subsidiaries are added together and thereafter the account balances and transactions between LBP and its subsidiaries or intragroup balances and transactions are eliminated to come up with the consolidated financial statements of the LBP Group. The transactions of the subsidiaries are mostly with LBP as parent and recognised and recorded in their respective books of accounts and in LBP's books of accounts.

1.3 Comparison of the balances of receivables and payables with subsidiaries in LBP books that were obtained from the schedules in Head Office and reports submitted by the auditors in the field units with that in the books of the subsidiaries as of December 31, 2016 disclosed that the balances of Receivables and Payables accounts differed by P81,820,840.73 and P394,996,935.71, respectively, as follows:

Subsidiaries	Receivables in LBP's books	Payables in subsidiary's books	Difference
LIBI	P1,235,593.75	P23,230,444.81	P21,994,851.06
LBRDC	167,632.79	0	167,632.79
LLC	1,962,901,163.15	1,962,554,166.77	346,996.38
MSI	1	59,311,361.50	59,311,360.50
Total difference of receivables balance with subsidiaries			**P81,820,840.73**

Subsidiaries	Receivables in subsidiary's books	Payables in LBP's books	Difference
LIBI	P53,514,611.62	P898,077.02	P52,616,534.60
LBRDC	149,856,224.82	93,695,500.55	56,160,724.27
LLC	265,309,834.72	43,834,730.87	221,475,103.85
MSI	66,870,796.99	2,126,224.00	64,744,572.99
Total difference of payables balance with subsidiaries			**P394,996,935.71**

1.4 The receivables account is composed of Accounts Receivable, Contracts Receivable, Retentions Receivables and Lease/Loans Receivable while the payables account consists of accounts payable, accrued expense payable, bills payable and finance lease payable and miscellaneous/other liabilities in either LBP or subsidiaries' books of accounts.

1.5 In preparing the consolidated financial statements of the LBP and its subsidiaries, the intragroup account balances and transactions are eliminated based on the balances of accounts in the subsidiaries' books and the data provided by the subsidiaries without reconciling with the balances of accounts in LBP's records. Thus, as shown above the balances of accounts in the LBP books differed from those of the subsidiaries.

1.6 Reconciliation of the intragroup account balances and transactions in the LBP books and that of subsidiaries is necessary to ensure that the transactions are properly recorded and account balances are faithfully represented in the consolidated financial statements. Otherwise, the balances of the accounts would be misstated in the separate financial statements either of the parent or the subsidiaries.

1.7 Hence, with the noted differences, the causes of which remain unknown in the absences of reconciliation, the faithful representation of the balances of receivables and payables accounts with the subsidiaries could not be established in the separate financial statements of the Parent and the consolidated financial statement as of December 31, 2016.

1.8 **We recommended that Management require the Financial Accounting Department and other concerned accounting units to perform reconciliation of the balances of receivables and payables in LBP books with that of subsidiaries books to present the balances of accounts in accordance with IFRS 10 in the financial statements as of December 31, 2016.**

1.9 Management agreed and explained that the noted discrepancies might be due to timing difference in processing and booking of transactions by the Bank and its subsidiaries.

Equity Investments

2. The equity investment in Small Business Corporation amounting to P360 million was classified as Investment in Non-Marketable Equity Securities (INMES) instead of Investment in Associate as required in Philippine Accounting Standard (PAS) 28 that overstated the INMES account and understated the Investment in Associates by P360 million.

2.1 Paragraphs 6 to 7, and 13 of PAS 28 are stated as follows:

> "6. If an investor holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence."
>
> "7. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
>
> a. representation on the board of directors or equivalent governing body of the investee; " (emphasis ours)
>
> "13. An Investment in an associate shall be accounted for using the equity method except when:
>
> (a) xxxx;
> (b) xxxx; or
> (c) xxxx"

2.2 As of December 31, 2016, Financial assets classified as Available-for-Sale showed a balance of P290,323,340,445.29, of which P7,278,297,752.98 pertains to Investment in Non-Marketable Securities (INMES) account where the equity investment in Small Business Corporation (SBC) amounting to P360,000,000.00 was recorded and measured at cost.

2.3 The equity investment in SBC represents 20.50 per cent of the entire capital stock and LBP has one representative in the Board of Directors. As cited above, with the investment holdings of more than 20 per cent and the presence of a representative in the Board Directors, it is presumed that LBP has significant influence over SBC unless there is clear evidence that will prove otherwise. Hence, this equity investment should have been recorded as Investment in Associate and measured at equity method in accordance with the above-cited paragraphs of PAS 28.

2.4 As a result, the financial assets classified as Available-for-Sale was overstated and the Investment in Associate was understated by P360,000,000.00 as at December 31, 2016.

2.5 **We recommended that Management require the Treasury Operations Department to record the equity investment in SBC amounting to P360 million, as Investment in Associate and measure it at equity method to correct the classification and presentation of the said accounts in the financial statements as at December 31, 2016.**

2.6 Management explained that LBP has no significant influence with SBC for the reason that it has only one seat out of the nine members and LBP has no assigned representative at present while four seats belong to the National Government in the SBC's Board.

2.7 Management further contented that paragraph 7 of PAS 28 states that "The existence of significant influence by an investor is **usually** evidenced in one or more of the following ways . . . .", which the word **"usually"** means it does **NOT** apply to all or true to all according to them. Likewise, paragraph 10 of PAS 28 provides that "An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of the investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to control of a government, court, administrator or regulator. It could also occur as a result of a contractual agreement."

2.8 As a rejoinder, paragraph 7 of PAS 28 enumerates the usual circumstances that would give evidence that there is significant influence and it may be true in other circumstances. Also, this is to emphasize that as defined in PAS 28, "Significant Influence is the power to participate in the financial and operating policy decisions of the investee but not control or joint control over those policies*".* Although LBP has only one seat out of the nine members of the SBC's board of directors and it has no assigned representative at present, LBP has still a representation in the SBC's board. Such representation serves as an evidence that LBP has significant influence aside from the fact that it holds more than 20 per cent of the capital stock of SBC unless there is a clear demonstration or indication that LBP does not have significant influence in this entity.

ROPA/Property Investment

3. The acquired properties of a real estate corporation was recorded as ROPA/Investment Property at P16.855 million instead of P176.893 million pursuant to PAS 40 that understated both the Real and Other Properties Acquired/Investment Property and Miscellaneous Income accounts by P160.038 million.

3.1 Paragraphs 5 and 20 of PAS 40 are provided as follows:

> "5. Cost is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other IFRS."

"20. An Investment Property shall be measured initially at its cost. Transaction cost shall be included in the initial measurement."

3.2 The Real and Other Properties Acquired (ROPA) account refers to real and other properties, other than those used for banking purposes or held for investment, acquired by the bank in settlement of loans through foreclosure or dation in payment and/or for other reasons, whose carrying amount will be recovered principally through a sale transaction. This account is used for financial statements that are presented in accordance with BSP's regulations and initially measured at outstanding balance of loan or bid price whichever is lower plus transaction costs. On the other hand, the Investment Property account is used for the said properties except those held for sale or used in operations in the financial statements that are presented in accordance with Philippine Financial Reporting Standards (PFRS) and initially measured at latest appraised value of the properties which is the deemed cost plus transaction costs.

3.3 In LBP-Head Office, the transactions of ROPAs account are recorded in the FMS ledgers of Loans Implementation Department (LID) and Special Assets Department (SPAD). Inquiry with management disclosed that those properties acquired in settlement of loans through foreclosure or dation in payment are booked initially in the FMS ledger of the branch concerned or LID and subsequently transferred to the ledger of SPAD upon expiration of the redemption period for monitoring and disposition.

3.4 As at December 31, 2016, ledgers of LID and SPAD in the FMS showed the following balances of ROPA:

	LID	**SPAD**	**Total**
Land	P90,788,806.37	P1,604,030,104.22	P1,694,818,910.59
Building	101,945,745.30	777,319,512.84	879,265,258.14
Other properties	8,071,600.00	24,502,524.51	32,574,124.51
Total	200,806,151.67	2,405,852,141.57	2,606,658,293.24
Accumulated depreciation	(11,224,400.36)	(538,599,845.40)	(549,824,245.76)
Allowance for losses	0.00	(122,155,345.22)	(122,155,345.22)
Net book value	**P189,581,751.31**	**P1,745,096,950.95**	**P1,934,678,702.26**

3.5 Verification of the CY 2016 transactions of the ROPA account revealed that the SPAD ledger for ROPA-Land included the properties acquired amounting to P16,855,000.00 which were previously owned by a real estate corporation. Said properties consist of 96,169 square meters of land which are covered by 149 Transfer Certificates of Title (TCTs) which are situated in Capitol District, Quezon City.

3.6 The above properties were acquired by LBP thru a compromise agreement with the Quezon City Government (QCG) relative to the settlement of QCG's trust account with the Trust Banking Group (TBG) of LBP. Sometime in 1980, LBP and QCG executed Deeds of Revocable Trust (Trust Account No. 01-152) whereby QCG as Trustor/Beneficiary, constituted and appointed LBP as Trustee, for the total amount of P30,000,000.00 to be invested by way of loan in favor of said real estate corporation . However, the corporation failed to pay or settle the Loan Agreement executed with LBP.

3.7 On March 27, 1981, LBP filed a civil case with the Regional Trial Court of Pasig City, Branch 153, for the collection of sum of money from the aforementioned corporation. Subsequently, LBP obtained a favorable judgment from the said case. To effect the judgment, LBP caused to levy the above properties which were then awarded to LBP, being the highest bidder, for the bid price of P16,855,000.00. A Certificate of Sale in favor of LBP was given by the Regional Trial Court of Pasig City on October 22, 1992.

3.8 On the other hand, QCG filed a civil case on October 11, 1982 with the Regional Trial Court of Quezon City, Branch 87 to recover their trust investment with LBP. Nevertheless, QCG and LBP decided to settle the case amicably wherein a Decision was rendered by the Regional Trial Court of Quezon City on September 29, 2015 based on the Compromise Agreement executed between LBP and QCG with the following stipulations among others:

> "1. The QCG's trust investment under Trust Account No. 01-152 in the principal amount of P30,000,000.00 and subject of pending Civil Case No. 36608 (RTC of Quezon City, Branch 87), shall be paid/settled in full by LBP in the following manner:
>
> > 1.1 The principal amount of PESOS THIRTY MILLION (P30,000,000.00) plus interest of PESOS ONE HUNDRED FORTY TWO MILLION EIGHT HUNDRED THOUSAND (P142,800,000.00) or a total of ONE HUNDRED SEVENTY TWO MILLION EIGHT HUNDRED THOUSAND PESOS (P172,800,000.00) shall be paid upon signing of the compromise agreement by both parties, ratification by the QCG Council and approval of the court;
> >
> > 1.2 The amount of P172,800,000.00 shall be subject to all existing government auditing rules and regulations and parties are bound to respect and comply thereto.
>
> 2. In consideration of and upon payment of the amount mentioned in paragraph 1.1 above, QCG does hereby absolutely, unconditionally, and irrevocably assign, cede, transfer and convey in favor of LBP the RAMAWIL properties, consisting of 96,169 square meters, more or less, and covered by 149 Transfer Certificates of Title (TCTs), more particularly listed and described in Annexes A, A-1 to A-150 of this Agreement, which forms an integral part hereof, including improvements found thereon.
>
> 3. All taxes that may be imposed by the national and local government pertaining to but not limited to capital gains and donor's tax relative to the transfer or assignment of the properties in favor of LBP shall be for its account."

3.9 LBP paid the amounts of P172,800,000.00 to QCG on January 18, 2016 under Disbursement Order No. 275894 and P4,093,317.84 for real property taxes or a total of P176,893,317.84. Records showed that the amount recorded as ROPA/Investment Property account was only P16,855,000.00 representing the bid price made sometime in 1981 when LBP was only a trustee then. The difference of P160,038,317.84 was debited to Miscellaneous Income account.

3.10 It may be noted, however, that the acquisition of the above properties of the real estate corporation was made thru purchase and not thru foreclosure or dation in payment, which make it different from other ROPAs. It is considered as a purchase because LBP paid the amount of P172,800,000.00 and assumed the liability for taxes in exchange for the absolute ownership of the said properties. Therefore, as provided in paragraphs 5 and 20 of PAS 40, the acquired properties should have been recorded as Investment Property at cost amounting to P176,893,317.84. Likewise, the same amount should have been recorded as ROPA account.

3.11 The foregoing circumstances resulted in the understatement of both the ROPA/Investment Property and Miscellaneous Income accounts by P160,038,317.84 as at December 31, 2016.

3.12 **We recommended that Management require the LID to make the necessary adjusting entry to record the above properties in accordance with paragraphs 5 and 20 of PAS 40.**

3.13 Management agreed to make the necessary adjusting entries in CY2017 upon the Board approval on the charging of the adjustment to surplus account/retained earnings.

Non-current Assets Held for Sale (NCAHS)

4. The properties of a resort hotel amounting to P117.730 million were not derecognized as asset despite receipt of the down payment of P50 million for the settlement of outstanding obligation of P332.372 million contrary to PAS 40 and PAS 18, resulting in the overstatement of the NCAHS account by P117.730 million and understatement of the Sales Contract Receivable and Net Income by P282.371 million and P164.641 million, respectively.

4.1 Relevant accounting standards are presented as follows:

a. PAS 40, paragraphs 66 and 67

> “66. An Investment property shall be derecognized (eliminated from the balance sheet) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits are expected from its disposal.”
>
> “67. The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property, an entity applies the criteria in PAS 18 for recognising revenue from the sale of goods and considers the related guidance in the Appendix to PAS 18.X x x x”

b. PAS 18, paragraph 14

> “14. Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied:

(a) The entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) The amount of revenue can be measured reliably;

(d) It its probable that the economic benefits associated with the transaction will flow to the entity; and

(e) The costs incurred or to be incurred in respect of the transaction can be measured reliably."

4.2 Investment Property account refers to properties acquired in settlement of loans through foreclosure or dation in payment, and that is not significantly occupied by LBP. On the other hand, Non-current Assets Held for Sale (NCAHS) are Real and Other Property Acquired (ROPA) that are available for immediate sale in their present condition subject only to the terms that are usual and customary for sale of such assets and the sale is highly probable.

4.3 As at December 31, 2016, the schedule of NCAHS account in Head Office showed a balance of P197,745,459.71 that included the various properties of a resort hotel amounting to P117,730,346.00. Verification disclosed that the said properties were recorded as Investment Property/ROPA on August 20, 1998 and were reclassified from Investment Property/ROPA to NCAHS account on June 10, 2016.

4.4 As a backgrounder, LBP extended a loan sometime in 1996 to the said resort hotel amounting to P200,000,000.00 which was secured by various properties of the hotel. Due to the hotel's failure to pay its loan, LBP pursued the foreclosure of the mortgaged properties which were then sold in a public auction where LBP was awarded as the highest bidder. Further, the hotel was not able to exercise its right to redeem the foreclosed properties, hence, the certificates of title of the foreclosed properties were consolidated in LBP's name.

4.5 Thereafter, LBP filed a petition for issuance of writ of possession while the hotel filed an action for annulment of foreclosure proceedings against LBP. On February 17, 2003, both parties filed a Joint Motion for Approval of Compromise Agreement which was subsequently approved by the trial court. The mutual covenants and stipulations of LBP and the hotel in the Compromise Agreement states, among others, that a down payment of P50 million shall be paid by the latter for its outstanding obligation of P332,371,570.31. In turn, LBP shall release 41 Condominium Certificates of Title. The balance of P282,371,570.31shall be paid over a period of five years.

4.6 However, the stipulations contained in the compromise agreement were not complied by the resort hotel. Several pleadings were filed by the hotel and LBP in trial courts, the last of which was the former's Motion for Reconsideration on the Resolution dated September 16, 2015. The said motion was filed before the Supreme Court which was then denied. Hence, the Court of Appeals' Decision on November 10, 2014 became final and executory. In the said decision, the hotel was given a period of 90 days to pay LBP the amount of P50 million as down payment and the remaining balance of P282,371,570.30 in accordance with the approved Compromise Agreement. Additionally, an interest of six per cent per annum was imposed on such total amount.

4.7 Records showed that the down payment of P50 million was received by LBP from the hotel on June 10, 2016. However, said payment was credited as Miscellaneous Income/loss. Management informed that LBP had already complied with their undertaking to release the 41 titles of the properties to the hotel. They also mentioned that documentary requirements are still in process. Hence the said properties are still presented as Non-Current Asset Held for Sale in the financial statements as at December 31, 2016.

4.8 Since LBP had already released the certificates of title and the hotel had already paid the down payment of P50 million to LBP, the properties are already deemed disposed and hence, should have been derecognized in accordance with paragraphs 66 and 67 of PAS 40. Although the certificates of title for the said properties are still in the name of LBP, the conditions stated under PAS 18 were already met. Thus, the subject properties are qualified to be recognized under Sales Contract Receivable instead of NCAHS.

4.9 Thus, the present classification of said properties overstated the NCAHS by P117,730,346.00 while the Sales Contract Receivable and Net Income were understated by P282,371,570.31 and P164,641,224.31, respectively, as at December 31, 2016.

4.10 **We recommended that Management require the Loans Implementation Department to make the necessary adjusting entry to derecognize the properties of the hotel as asset for the fair presentation of affected accounts in the financial statements as at December 31, 2016.**

4.11 Management agreed and further informed that the reclassification entry from NCAHS to Sales Contract Receivable will be taken up in the books of accounts within June 2017.

Accounts Receivable- Government Entities (AR-GE)

5. The CCT service fees receivable from the Department of Social Welfare and Development aggregating P213.570 million were not recognized in the books resulting in the understatement of Accounts Receivable-Government Entities (AR-GE) and Fees and Commission Income accounts by the same amount and contributed to the total variance of P220.199 million between the General Ledger and Subsidiary Ledger balances of the A/R-GE account.

5.1 In our previous year's audit observations, we noted the existence of variance between the General Ledger (GL) and Subsidiary Ledger (SL) balances of the A/R-GE account for advances made on Inter-Bank (IB) withdrawals representing Conditional Cash Transfer (CCT) transactions, other Service Fees receivable by the Bank from the Department of Social Welfare and Development (DSWD), as well as the unrecorded Fees and Commission Income representing fees for Cash Card produced and issued to CCT beneficiaries that are subsidized by DSWD, respectively.

5.2 The said observations were excluded in the Annual Audit Report on LBP for CY2015 because Management agreed to have a centralized booking unit of A/R-GE account starting in June 2016 during the Bank Wide Exit Conference conducted on June 17, 2016. This unit will only be distributed to the servicing branches via Management Information System (MIS) for easy monitoring. Management was not able to submit a journal ticket showing the accounting entries made to record and adjust the A/R-GE and Fees and Commission Income accounts in LBP-Batasan Branch.

5.3 Review of Monitoring Reports from CCT-PMO, copies of billing statements and attached supporting documents sent to DSWD (which serves as the SL), as well as the A/R-GE account as reflected in LBP-Batasan Branch (which serves as the GL) showed a variance of P220,198,637.18, as at December 31, 2016. Details are presented as follows:

Particulars	Year	LBP Batasan Branch	CCT-PMO	Variance (Absolute Value)	Remarks
1. Advances made for Inter-bank withdrawal	2013	P20,827,555.00	P20,834,235.00		
	2014	1,545,982.99	2,212,534.00		
	2015	10,650,555.98	10,040,785.98		
	2016	17,515,330.11	22,397,111.48		
		50,539,424.08	55,484,666.46	P4,945,242.38	
2. Cash Card Production Fee @ P50 per card	2012	0	4,181,550.00		
	2013	0	8,383,150.00		
	2014	0	2,128,850.00		
	2015	0	0		
	2016	16,409,787.50	32,950.00		
		16,409,787.50	14,726,500.00	1,683,287.50	
Subtotal				*6,628,529.88*	
3. Cash Card Withdrawal Fees @ P14 per transaction	2014	0	5,194,547.15	5,194,547.15	Booked 6/9/17 part of P90,710,552.44
	2015	0	16,669,757.28	16,669,757.28	Booked 6/9/17 part of P90,710,552.44
	1st to 3rd quarter of 2016	0	54,196,590.00	54,196,590.00	Booked 6/9/17 part of P98,309,355.92
	4th quarter of 2016	0	12,946,612.00	12,946,612.00	
		0	89,007,506.43	89,007,506.43	
4. Procurement of Conduits Expenses	2015	0	15,284,567.27	15,284,567.27	Booked 6/9/17 part of P90,710,552.44
	1st to 3rd quarter of 2016	0	15,594,479.32	15,594,479.32	Booked 6/9/17 part of P98,309,355.92
	4th quarter of 2016	0	1,262,839.59	1,262,839.59	
		0	32,141,886.18	32,141,886.18	
5. Man power and other expenses	2014	0	14,817,338.85	14,817,338.85	Booked 6/9/17 part of P90,710,552.44
	2015	0	38,744,341.86	38,744,341.86	Booked 6/9/17 part of P90,710,552.44
	1st to 3rd quarter of 2016	0	28,518,286.61	28,518,286.61	Booked 6/9/17 part of P98,309,355.92
	4th qtr. 2016	0	10,340,747.37	10,340,747.37	
		0	92,420,714.69	92,420,714.69	
				P213,570,107.30	
Total Variance				**P220,198,637.18**	

Booked by Batasan Branch on 6/917 part of P90,710,552.44
Booked by Batasan Branch on 6/9/17 part of P98,309,355.92

5.4 Above noted variance of P220,198,637.18 indicates that the Bank was not able to fully implement the provisions of Item b (1), paragraph X185.2 of the Manual of Regulations for Banks (MORB) Series of 2012 requiring *monthly reconciliation of general ledger balances against respective subsidiary and supporting records and* *documentation by someone other than the bookkeeper or the person handling the records.*

5.5 As can be gleaned from the above table, the significant portion of the variances aggregating P213,570,107.30 was due to unrecorded CCT service fees receivable from DSWD, contrary to paragraphs 20 and 23 of PAS 18 which provide the following:

> Paragraph 20
>
> "When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction at the balance sheet date. xxx" (Underscoring ours)
>
> Paragraph 23
>
> "An enterprise is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction: (Underscoring ours)
>
> (a) Each party's enforceable rights regarding the service to be provided and received by the parties;
> (b) The consideration to be exchanged; and
> (c) The manner and terms of settlement."

5.6 Also, it was provided in the Implementing Rules and Regulations (IRR) of the Memorandum of Agreement (MOA) between LBP and DSWD that *DSWD shall remit payment to LBP within one month from receipt of Billing Statement for Cash Cards cost of fifty pesos (P50.00) each. While DSWD shall reimburse within five (5) workings days upon receipt of LBP's weekly billing supported by proof of the IB withdrawals made by beneficiaries for Advances made by LBP for IB withdrawal fees charged by other banks up to the amount of twenty pesos (P20.00) per transaction of CCT beneficiaries*.

5.7 The Supplemental MOA also provided the agreed computation and collection of expenses for the services rendered by the Bank effective year 2014 on Cash Card Withdrawal and ATM Expenses of P14.00 per beneficiary net of potential revenues from DSWD's deposits-Average Daily Balance; three per cent of the Contract Approved Budget for Procurement of Conduits Expenses and the Manpower Cost and other expenses incurred by the Bank Units related to CCT program.

5.8 Considering the provisions under paragraphs 20 and 23 of IAS 18, as well as the MOAs, the claims for services rendered by the bank in the implementation of CCT Program were valid and were due and demandable from DSWD.

5.9 Further verification disclosed that the CCT-PMO requested the LBP- Batasan Branch to book the said valid claims from CY2014 and CY2015 on September 1, 2016 and reiterated the same request on January 4, 2017. However, the same was not yet booked due to lack of approval for booking. Thus, on May 31, 2017, the CCT-PMO elevated its request to the Bank President for booking of the same as per the Codified Approving/Signing Authority (CA/SA). However, it took eight months to more than two years to record the subject transactions in the books. This was due to the previous practice of the bank not to set-up a receivable account but to record income only upon receipt of payment from DSWD.

5.10 The said practice resulted in the variance amounting to P1,683,287.50 and overstatement of Accounts Receivable (AR) and Fees and Commission Income by P1,716,237.50 due to double recording of the transactions as AR on May 5, 2016 and June 16, 2016 despite payment in December 2015 as indicated in the CCT-PMO Monitoring Report (MR) and recognition of income, as illustrated below:

Year	Particular	Variance	Remarks
2015	CC generation Jan, to Feb. 2015	P49,937.50	Billed by CCT-PMO to DSWD on02/27/15 & 03/06/15, which was subsequently paid on 03/26/15 & 04/20/15. But CCT-PMO erroneously encoded the amount (net of tax) instead of the total DV amount paid. Hence, their Monitoring Report reflected a Receivable balance of P49,937.50, instead of fully paid. This was already corrected in the CCT-PMO monitoring report, but part of the P883,087.50 requested for booking and booked by the Branch on 06/16/16.
2015	CC generation Aug. to Sept. 2015	833,150.00	Billed by CCT-PMO to DSWD in 08/15 & 09/15 and was subsequently paid on 12/29/15.
		883,087.50	Booked as part of P15.577 million in 06/16/16 even if income was already recognized upon receipt of payment on 12/29/15.
2016	CC generation Aug. to Sept. 2015	833,150.00	Recorded as AR on 05/05/16, even if income was already recognized upon receipt of payment on 12/29/15.
		P1,716,237.50	**Total Overstatement of AR and Fees and Commission Income**
2016	CC generation Feb. to April 2016	32,950.00	Booked as AR on May 8, 2017 per Batasan communication to CCT-PMO, Memo for booking was on 05/02/17 for Feb. to April transactions
Variance		P1,683,287.50	

5.11 As shown in the table presented under paragraph 5.3, the variance of P4,945,242 represents the DSWD payments for IB withdrawals that were not reflected in the CCT-PMO Monitoring Report.

5.12 Moreover, as gathered from Management, the Cash Card withdrawal fees, procurement of conduit expenses, manpower and other operating expenses for the fourth quarter of 2016 were billed to DSWD only on May 25, 2017 and June 14, 2017, respectively, or almost six months after the end of the said quarter. Thus, it contributed to the accumulation of variance for AR/GE and Fees and Commission since it is the communication from CCT-PMO to the Batasan Branch that triggers the latter to book the transactions in their book of accounts. Further, late billing to DSWD might lead to long outstanding AR in the books due to the long process of money claims from DSWD considering the budgetary concern of the Department, being a national government agency receiving the funds from the National Government.

5.13 The unrecorded fees for services rendered in the implementation of CCT Program further resulted in understatement of A/R-GE and Fees and Commission Income accounts as at December 31, 2016. Likewise, non-collection of the said huge amount deprived the Bank of opportunity income that can be used in investing and lending activities.

5.14 Although Management submitted the journal tickets to record the CCT Service Fee totalling P213,570,107.32, the same were recorded only in CY 2017 instead of CY2016.

5.15 **We recommended that Management require:**

a. LBP Batasan Branch and CCT-PMO to:

a.1 regularly reconcile the AR/GE (DSWD) account balance as provided in the Manual of Regulations for Banks (MORB) on independent balancing, as well as to intensify the reconciliation, verification and analysis of the causes of the noted variance between the GL and SL of the said account to avoid occurrence of the same deficiencies in the future, and

a.2 ensure that their records are reconciled before a request for booking/recording of the Accounts Receivable and Fees & Commission Income from DSWD is made to avoid the double recording as well as the over/understatement of the account; and

b. CCT-PMO to prepare and send billing statement to DSWD on a timely manner and enforce collection with reference to the cited provisions in the IRR that DSWD shall reimburse the advances paid by LBP within five (5) working days upon receipt of LBP's weekly billing with attached supporting documents, and that DSWD shall remit payment to LBP within one (1) month from receipt of Billing Statement for Cash Cards.

Salary /Livelihood Loans Receivable

6. Past due Loans to Individual for Other Purposes-Salary/Livelihood Loan have accumulated to P68.650 million due to non-implementation of the pertinent provisions of LBP Executive Order Nos. 035 and 042, series of 2013 and 2015, respectively, and the Memorandum of Agreement (MOA) between LBP and participating government agencies, thus, exposing the loan fund to losses.

6.1 LBP Executive Order No. 035, Series of 2013, provided guidelines to ensure uniform implementation of the Enhanced Livelihood Loan Facility. These guidelines cover the processing and management of livelihood loans thru Online Livelihood Loan System (LLS).

6.2 Executive Order No. 042, Series of 2015, prescribed the guidelines on the Implementation of the Land Bank Mobile Loan Saver (LMLS). LMLS is a mobile-based savings-linked salary loan product of the Bank in partnership with SMART e-Money, Inc. (SMI). LMLS provides convenience to LBP clients through an electronic channel on salary loan with auto-savings component offered to employees of private companies and government offices.

6.3 The MOA between LBP and participating government agencies expressly states that the client government agencies shall perform the following:

a. Collect or cause the collection of the instalments/amortizations due on the loans of their employee/borrowers through automatic salary deductions; and remit to LBP not later than five banking days after the scheduled remittance date until full settlement of the loan.

b. In case of transfer or reassignment of employee/borrower within his agency, reassignment of a borrower to another government agency; or termination/separation from service of a borrower, the loan shall become due and demandable. For this reason, the agency shall require the employee/borrower to secure prior clearance from LBP to ensure settlement of his obligation.

c. Ensure adherence of its employees-borrowers/co-makers in the Livelihood Loan Program guidelines.

6.4 It was also stipulated in paragraph G of the MOA that the livelihood loan shall be secured by the borrower's assignment of his salaries, allowances, bonuses, retirement benefits, separation/gratuity pay, monetary value of accumulated leave credits and other monetary receivable from the Agency and ATM payroll account in favor of LBP.

6.5 The accumulation of past due accounts demonstrates non-compliance by the participating government agencies with the provisions of LBP EO Nos. 035 and 042, series of 2013 and 2015, respectively, and the MOA such as collection of loan amount through automatic payroll deductions, remittance of collections within five days and withholding of money from retired/separated borrowers.

6.6 As at December 31, 2016, the branches had an actual past due salary loan accounts of P68,649,526.39 broken down as follows:

Region	Branch/Agency	Total Past Due-Actual (In Peso)		
		LLS	LMLS	TOTAL
Reg. II	Tuguegarao	P 0	P5,679,117.41	P5,679,117.41
	Luna	0	520,395.41	520,395.41
	Tabuk	0	107,138.40	107,138.40
	Aparri	0	82,587.59	82,587.59
	Sanchez Mira	0	21,649.50	21,649.50
		0	6,410,888.31	6,410,888.31
Reg. III	Balanga	584,326.87	0	584,326.87
	Castillejos	0	161,075.09	161,075.09
	DepEd Olongapo	2,777.70	0	2,777.70
	OCNHS	35,266.76	0	35,266.76
	Olongapo	0	808,102.56	808,102.56
	San Antonio	286,962.63	0	286,962.63
	Subic	0	168,858.55	168,858.55
(Subic)	Columban	0	288,052.98	288,052.98
	HHIC-TECH	0	168,999.58	168,999.58
	SBMA	0	745,945.03	745,945.03
	SBYC	0	310,471.25	310,471.25
	UBHMC	0	699,943.15	699,943.15
		909,333.96	3,351,448.19	4,260,782.15
Reg IV-A	Binangonan, Rizal	1,313,133.66	0	1,313,133.66
	Rosario, Batangas	54,179.38	0	54,179.38
	Tanay, Rizal	1,936,093.87	0	1,936,093.87
		3,303,406.91	0	3,303,406.91
Reg IV-B	Boac, Marinduque	0	2,278,081.32	2,278,081.32
	Brooke's Point, Palawan	0	121,692.57	121,692.57
	Coron, Palawan	0	585,537.35	585,537.35
	Puerto Princesa City, Palawan	1,737,854.97	693,209.61	2,431,064.58
	Calapan, Or. Min.	2,825,027.86	820,141.59	3,645,169.45

Region	Branch/Agency	Total Past Due-Actual (In Peso)		
		LLS	LMLS	TOTAL
	Pinamalayan & Roxas EO, Or. Min.	1,989,691.19	492,215.94	2,481,907.13
	Odiongan, Romblon	0	10,866,445.50	10,866,445.50
	Mamburao & Sablayan EO, Occ. Min.	0	1,785,011.12	1,785,011.12
	San Jose, Occ. Mindoro	0	12,766,659.30	12,766,659.30
		6,552,574.02	30,408,994.30	36,961,568.32
Reg. VII	Kalibo	746,718.62	71,035.16	817,753.78
Region VIII	Baybay	29,707.50	0	29,707.50
	Maasin	329,131.30	0	329,131.30
	Naval	301,219.44	488,247.95	789,467.39
	Ormoc	1,639,035.75	1,119,771.86	2,758,807.61
	Real	424,240.86	262,428.52	686,669.38
	Sogod	580,181.53	0	580,181.53
	Tacloban	3,164,952.03	0	3,164,952.03
		6,468,468.41	1,870,448.33	8,338,916.74
Region X	All Branches	160,410.60	629,057.17	789,467.77
Reg. XIII	Bislig, Surigao del Sur	7,738,742.41	0	7,738,742.41
	Dinagat Is., Surigao del Norte	28,000.00	0	28,000.00
		7,766,742.41	0	7,766,742.41
G R A N D	**T O T A L**	**P25,907,654.93**	**P42,741,871.46**	**P68,649,526.39**

Note: Actual Past Due- when the borrower fails to pay three months or three monthly installments or when the total amount of arrearages reaches 20 per cent of the total outstanding balance.

6.7 Non-payment of loans on scheduled dates resulted in increase in past due accounts, thereby, decreasing the chances of recovering the loan exposure that could affect the financial performance of the Bank.

6.8 **We recommended that Management continuously monitor the increasing past due accounts of LLS and LMLS and see to it that the provisions of the MOA between LBP and the participating government agencies regarding the collection of loan payments from their respective employees, and remittance to the Bank of the same are adhered to.**

6.9 As at December 2016, validation showed that the Past Due Non-Performing Livelihood/Salary Loans portfolio increased from P455,290,884.75 in CY 2015 to P471,134,090.88 in CY 2016, or a total increase of 3.48 per cent. For CY 2016, the same observation were issued by the Audit Teams to 40 Regional Branches aggregating P68,649,526.39.

Deposit Liabilities

7. Dormant Accounts of various LBP branches that had been outstanding in the books for ten years or more in the amount of P65.463 million were not reclassified to “Other Credits – Unclaimed Balances” as required in Section C.1, Chapter 8 of the LBP Branch Operations Manual, thus resulting in overstatement of Deposit Liabilities account and understatement of Other Liabilities account by P65.463 million.

7.1 Section C.1, Chapter 8 of the LBP Branch Operations Manual, on the Handling of Dormant Deposit Accounts states that:

"Section C. Reclassification to Other Credits – Unclaimed Balances

1. A review of dormant accounts shall be conducted thirty (30) days before the end of every year to identify accounts which have been dormant for ten (10) years or more. Accounts thus identified shall be reclassified to "Unclaimed balances" account."

2. Every November of each year, Technology Management Group (TMG) shall generate a Report of Unclaimed Balances. Based on this report, the Branch shall:

a. Manually debit the balances of the dormant accounts.
b. Perform ST60 to zero out any interest accrued for the account.
c. Close the account through ST23.
d. Reclassify the account as "Other Credits-Unclaimed Balances Account"."

7.2 R. A. No. 3936, as amended by Presidential Decree (P. D.) No. 679 dated April 2, 1975, requires banks, trust corporations and building and loan associations to transfer unclaimed balances held by them to the Treasurer of the Philippines as follows:

"Section 1. "Unclaimed balances", within the meaning of this Act, shall include credits or deposits of money, bullion, security or other evidence of indebtedness of any kind, and interest thereon with banks, buildings and loan associations, and trust corporations, as hereinafter defined, in favour of any person known to be dead or who has not made further deposits or withdrawals during the preceding ten years or more. Such unclaimed balances, together with the increase and proceeds thereof, shall be deposited with the Treasurer of the Philippines to the credit of the Government of the Republic of the Philippines. X x x."

7.3 Review of the dormant account schedules of LBP branches disclosed that there were accounts that had been dormant for ten years and over but were not reclassified to "Other Credits – Unclaimed Balances". The details are summarized below:

Region	No. of Branches/Branch	Total
NCR-North	12	P 42,517,217.82
NCR-South	10	4,110,039.44
I	3	1,426,690.57
II	6	974,071.58
V	Tabaco Branch	116,107.95
VI	Roxas Branch	4,235,856.93
VII	Dumaguete Branch	964,232.97
VIII	4	1,561,171.70
IX	6	5,745,764.29
X	6	1,654,247.81
XI	Matina Branch	2,016,795.29
XIII	3	141,191.86
Grand Total		**P 65,463,388.21**

7.4 Pending the reclassification of dormant accounts to Other Credits-Unclaimed Balances account, the Deposit Liabilities account and Other Liabilities account were overstated and understated, respectively by P65.463 million in the financial statements. Further, these accounts would not be reported for escheatment in favor of the government.

7.5 **We recommended that Management require the concerned branches to:**

a. Record the reclassification of deposit accounts, which had been dormant for ten years or more to Other Credits – Unclaimed Balances account to facilitate the transfer of these balances to the Bureau of Treasury;

b. Closely adhere to the policies and procedures in handling dormant deposit accounts as provided in Chapter 8 of LBP Branch Operations Manual such as, continuous sending of notices by mail of the actual transfer of their accounts to dormant status, and thereafter request to confirm their balances at least once a year; and

c. Initiate enhancement of the system to generate list of accounts reaching its ninth year as basis for sending Final Notices to depositors advising them of the impending reclassification of their accounts to unclaimed balance status and eventual escheatment of the account balances in favor of the Republic of the Philippines.

7.6 We acknowledge the immediate response of the Management. As of June 22, 2017, the balances of the total deposits not reclassified to Other Credits – Unclaimed Balances decreased from P65,463,388.21 to P11,551,403.74, as follows:

Region	No. of Branches/Branch	Total	Reclassified to Other Credits/Closed/ Reactivated/ Reversed/ HYSA	Updated Total Deposits
CR-North	12	P42,517,217.82	P42,517,217.82	P 0
NCR-South	10	4,110,039.44	1,971,357.55	2,138,681.89
I	3	1,426,690.57	814,857.76	611,832.81
II	6	974,071.58	659,795.38	314,276.20
V	Tabaco Branch	116,107.95	34,353.47	81,754.48
VI	Roxas Branch	4,235,856.93	2,684,404.52	1,551,452.41
VII	Dumaguete Branch	964,232.97	427,292.34	536,940.63
VIII	4	1,561,171.70	1,110,437.02	450,734.68
IX	6	5,745,764.29	0	5,745,764.29
X	6	1,654,247.81	1,654,247.81	0
XI	Matina Branch	2,016,795.29	2,016,795.29	0
XIII	3	141,191.86	21,225.51	119,966.35
Grand Total		**P 65,463,388.21**	**P53,911,984.47**	**P 11,551,403.74**

Other Credits-Unclaimed Balances

8. The accounts reclassified to Other Credits – Unclaimed Balances of various LBP branches in the amount of P6.534 million were not closed/removed from the books of the Branches and transferred to Administrative Accounting Department (AAD) for escheatment in accordance with Chapter 8.D of the LBP Branch Operations Manual.

8.1 Chapter 8.D of the Branch Operations Manual states that:

"Section D, Escheatment in Favor of the Republic of the Philippines

1. The accounts classified as "Unclaimed Balances Accounts" shall be closed /removed from the books of the Branch and transferred to AAD thru IBTOLS not later than the first week of January of every odd year (i.e., 2013, 2015, etc.).
2. The transfer shall be supported by a Sworn Statement of Unclaimed Balances (SSUB) for submission to AAD for filing with the BTr."

8.2 Verification of branches' records as of December 31, 2016 revealed that the Dormant Accounts for ten years or more in the amount of P6,534,413.43 were not closed/removed from the books of accounts, as follows:

Region	Branch	Total
NCR	Cash Plaza	P 212,900.49
I	Batac City	162,223.86
I	San Fernando City (LU)	394,444.62
VI	Kalibo	5,764,844.46
TOTAL		**P6,534,413.43**

8.3 Section X264 of the MORB for Banks states that, "All unclaimed balances, which include credits of deposits of money, bullion, securities or other evidences of indebtedness of any kind, and interest thereon already reported to the Treasurer of the Philippines in accordance with the Unclaimed Balances Act shall be transferred/reclassified from the deposit liability/other credit accounts to the liability account, Due to the Treasurer of the Philippines."

8.4 **We recommended that the Management requires the concerned branches to derecognize from the books the accounts classified as "Unclaimed Balances" and transfer to AAD thru Inter-branch transaction on-line system (IBTOLS) not later than the first week of January of every odd year.**

8.5 As of June 22, 2017, the amount of P1,568,135.40 booked as Other Credits-Unclaimed Balances Payable of various LBP branches were already transferred to AAD for escheatment. Hence, the total amount for escheatment decreased to P4,966,278.03, as follows:

Region	Branch	Total	Reversed	Updated Amount
NCR	Cash Plaza	P212,900.49	P212,900.49	P 0
I	Batac City	162,223.86	162,223.86	0
I	San Fernando City (LU)	394,444.62	394,444.62	0

Region	Branch	Total	Reversed	Updated Amount
VI	Kalibo	5,764,844.46	798,566.43	4,966,278.03
TOTAL		**P6,534,413.43**	**P1,568,135.40**	**P4,966,278.03**

ATM Shortages and Overages

9. Unaccounted Automated Teller Machine (ATM) overages and shortages amounting to P3.388 million and P1.395 million, respectively, were not immediately reconciled, reviewed and investigated for proper disposition/treatment, thus, these overages and shortages remained outstanding in the books of the various LBP branches as at year-end.

9.1 Item B.3 (c) 2 (a) and (b) of LBP Executive Order No. 01, s.2004, dated January 30, 2004 provides that:

> "If shortage/overage is not accounted for, the ATM and Cash Management Department (ACMD) shall recommend reversal of the overages/shortages to appropriate account.
>
> *a)* All unaccounted overages still unclaimed after the end of the quarter following the date of booking shall be reversed to *"Miscellaneous Income".*
>
> b) All unaccounted shortages shall be reversed to "*Miscellaneous Expense*" every December 20th of the current year covering 1st day of December of the previous year up to November 30th of the current year."

9.2 Item C.4, Chapter 11 of the Branch Operations Manual on ATM operations provides these parts: Shortages and Overages which cannot be accounted for by the Branch upon cash retrieval due to possible machine-related problems shall be elevated to ATM and Cash Management Department (ACMD) within three banking days from transaction/retrieval date. The Branch concerned shall accomplish the ATM Shortages/Overages Review Approval Form and submit photocopies of the following documents:

a. Cash Retrieval Proof
b. Final Terminal Reading
c. CIV-ATM Cash Book (from date of prior loading up to date of retrieval)
d. Transaction Journal Tapes (for Diebold) or Diskette file from loading up to retrieval date (for Tapeless)
e. List of Resolved and Unresolved Recon Items
f. EJ (Backup file)
g. TDRST Bundle 1b (Backup file)

9.3 Item C.5, same chapter of Branch Operations Manual on ATM Operations also provides that after thorough review and investigation, the ACMD shall advise the Branch of its findings/recommendations by accomplishing the appropriate space on the ATM Shortages/Overages Approval form.

9.4 The Schedule of Overages and Shortages showed various ATM overages aging 90 days or more and shortages aging 31 days or more that were not adjusted/reversed within the timelines as provided for in LBP Executive Order No. 1 dated January 30, 2004 and remained outstanding as at year-end amounting to P3,387,948.77 and P1,395,412.00, respectively, as follows:

Region	Overages		TOTAL	Shortages		TOTAL
	91-360 days	> 360 days		31-360 days	> 360 days	
North NCR	P1,552,668.77	P518,770.00	P2,071,438.77	P625,700.00	P405,212.00	P1,030,912.00
South NCR	502,800.00	18,700.00	521,500.00	174,800.00	12,300.00	187,100.00
Reg. IV-A	78,500.00		78,500.00	30,500.00		30,500.00
Reg. IV-B	50,800.00		50,800.00	21,200.00		21,200.00
Reg. VI	37,580.00		37,580.00	36,000.00		36,000.00
Reg. X	197,600.00	276,600.00	474,200.00	80,100.00		80,100.00
ARMM	153,930.00		153,930.00	9,600.00		9,600.00
Total	**P2,573,878.77**	**P814,070.00**	**P 3,387,948.77**	**P977,900.00**	**P417,512.00**	**P1,395,412.00**

9.5 Considering that these overages and shortages have been outstanding in the books of accounts for over for over 90 and 30 days, respectively as at December 31, 2016, these should have already been properly classified to their corresponding accounts.

9.6 **We recommended that Management revisit the guidelines on handling of ATM overage/shortage particularly the reversal period of unaccounted ATM overages/shortages to Miscellaneous Income/Expense to facilitate the proper settlement and handling of reconciling items.**

9.7 We acknowledge the action taken by Management. As of June 2017, the Overages and Shortages account balances decreased to P1,144,010.00 and P284,500.00, respectively, as follows:

Region	Overages	Reconciled/ Reversed Misc Income/ Credited back to client	Updated Amount	Shortages	Reconciled/ Reversed to Misc Expense/ Paid	Updated Amount
North NCR	P2,071,438.77	P2,071,438.77	P 0	P1,030,912.00	P1,030,912.00	P 0
South NCR	521,500.00	25,400.00	496,100.00	187,100.00	36,900.00	150,200.00
Reg. IV-A	78,500.00	1,300.00	77,200.00	30,500.00	3,700.00	26,800.00
Reg. IV-B	50,800.00	35,700.00	15,100.00	21,200.00	13,600.00	7,600.00
Reg. VI	37,580.00	9,600.00	27,980.00	36,000.00	0	36,000.00
Reg. X	474,200.00	100,500.00	373,700.00	80,100.00	25,800.00	54,300.00
ARMM	153,930.00	0	153,930.00	9,600.00	0	9,600.00
Total	**P3,387,948.77**	**P2,243,938.77**	**P1,144,010.00**	**P1,395,412.00**	**P1,110,912.00**	**P284,500.00**

Provision for Income Tax

10. The assumption in estimating the Provision for Income Tax amounting to P746.801 million for CY 2016 was not consistently applied, and the adjustment on the previous year's estimate of the income tax was not properly recorded, thereby, undermining the faithful presentation of the said account and its related balances in the financial statements.

10.1 Paragraphs 31 and 86 of the Framework for the Preparation and Presentation of Financial Statements are as follows:

> "31. 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."
>
> "86. The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated. The use of reasonable estimates is an essential part of the preparation of financial reports and does not undermine their reliability."

10.2 As at December 31, 2016, records showed the following balances of accounts related to income tax:

Accounts	Amount
Accounts Receivable – Others – Government Entities	255,336,303.61
Miscellaneous Assets – Others	625,413,045.06
Income Tax Payable	0.00
Provision for Income Tax – Current	746,801,450.20

10.3 The Accounts Receivable – Others – Government Entities represents the Creditable Withholding Taxes (CWT) deducted by clients of LBP, which are to be applied as deduction from the amounts to be paid for income tax and gross receipt tax, while the Miscellaneous Assets – Others account is the excess of tax credits over the income tax due as of the reporting period.

10.4 LBP, which is considered a domestic corporation, is subject to 30 per cent income tax and required to file the quarterly Income Tax Returns (ITRs) from first to third quarters on or before the 60th day following the close of each quarter and annual ITR on or before April 15 of the following taxable year.

10.5 Verification disclosed that there were variances in the balances of accounts related to income tax between the books of accounts as at December 31, 2016 and the annual ITR filed with the Bureau Internal Revenue (BIR) sometime in April 2017, as presented below:

Accounts	Per FS	Per ITR	Variance
Provision for income tax	746,801,450.20	380,141,247.86	366,660,202.34

Miscellaneous Assets	625,413,045.06	1,518,501,721.45	893,088,676.39
Accounts Receivable – Others – Government Entities	209,498,263.25	357,487,802.00	147,989,538.75

10.6 Records showed that the amount of the Provision for Income Tax of P746,801,450.20 for the year ended December 31, 2016 as shown in the financial statements was based on the projected percentages of increase in income and expenses for the month of December 2016, which were ten per cent for income and interest expense and 13 per cent for general and administrative expenses. The projected percentages were derived from the monthly changes of income and expenses in the immediate previous three months.

10.7 However, it was noted that the rate of ten per cent was applied in the Total Gross Income but was not applied for all tax-exempt earnings that were deducted from the Total Gross Income to arrive at the Gross Taxable Income. Had the rate been consistently applied, the estimated income tax expense would have been lower by approximately P96,564,423.81, as follows:

Account	Per LBP	Based on 10% increase of income	Difference
Gross income	49,841,750,519.09	49,841,750,519.09	0.00
Less: Tax exempt earnings	22,532,961,996.05	22,854,843,408.75	321,881,412.70
Gross taxable income	27,308,788,523.04	26,986,907,110.34	321,881,412.70
Less: Allowed deductible expenses	24,833,999,267.94	24,833,999,267.94	0.00
Net taxable income	2,474,789,255.10	2,152,907,843.40	321,881,412.70
Tax Due	742,436,776.53	645,872,352.72	96,564,423.81

10.8 It is worthy to mention that for the past four years, the amounts reported as income tax due in the ITR showed a significant difference with the balances of income tax expense in the books of accounts, as shown below:

	CY2012	CY2013	CY2014	CY2015
Income tax per ITR	1,470,070,122	2,026,738,938	685,921,126	795,381,562
Income tax expense per books	806,466	3,047,119	1,054,310,931	171,859,954
Difference	**1,469,263,656**	**2,023,691,819**	**(368,389,805)**	**623,521,608**

10.9 The foregoing practice indicates that the assumptions in estimating the income tax expense were not proper to come up with a reasonable amount that would more or less approximate the actual income tax expense for the reporting period. With the huge amounts of difference between the accounting records and those reported in the annual Income Tax Return for five years including the current year, LBP must consider the balances of income and expense accounts as at the date nearest to the period end.

10.10 In addition, since there was a change in the estimate of income tax expense for CY 2015, such change should have been recognised prospectively in the profit or loss as provided in PAS 8. However, the journal entry made in 2016 to adjust the income tax expense that was reflected in the CY2015 financial statements based on the data reported in the Annual ITR for CY2015 was not properly made as presented below:

Entry made	Should be entry

Miscellaneous asset (Dr.)	168,940,672.05	Miscellaneous asset (Dr.)	168,940,672.05
Income tax payable (Cr.)	168,940,672.05	Income tax expense(Cr.)	168,940,672.05

Had the assumption in estimating the income tax expense been consistently applied and the adjustment for 2015 income tax expense been properly made, the difference between the books of accounts and ITR would have been reduced to P101,155,106.48.
10.11 In view of the foregoing, we could not rely on the faithful presentation of the Provision for Income Taxes and its related accounts as of December 31, 2016.

10.12 **We recommended that Management:**

a. Consistently apply the assumptions in estimating the provision for income tax and if possible consider the data of income and expenses as at the date nearest to the period end, and

b. Record the effect of change in estimate of income tax expense prospectively in the profit or loss.

10.13 Management explained that the Provision for Income Tax-Current was measured using the best estimate and the evidence is that they even reversed an amount on the Provision for Income Tax-Current in December 2016. Further, they can only determine the amount of adjustment when the computation on the 2016 annual ITR is done, thus the adjustment will be recorded and will become part of the 2017 computation which is in consonance with the provisions of applicable PAS.

10.14 As a rejoinder, the assumption in estimating the income tax expense must generate an amount that is reasonable so as it would not create perception on the users of the financial statements that the reported income tax expense was not a faithful representation of the transactions related to income tax considering the huge amount of difference between the amount presented in the financial statements and the actual amount filed/ paid with the BIR. Hence, we maintain our recommendation.

B. Improvement Opportunities in Operations

Outsourcing of ATM Cash Loading and First Level Maintenance

11. The outsourced ATM Cash Loading and First Level Maintenance (FLM) Services did not meet the expected ATM availability and efficiency of the ATM cash loading and FLM operations of the Bank.

11.1 In 2012, LBP entered into a contract with the Third Party Service Provider (SP) for the outsourcing of its ATM cash loading and FLM operations in the amount of P160,425,000 for three years for the purpose of achieving the following objectives:

- To improve ATM availability rate resulting in enhanced customer service;
- To improve efficiencies in ATM Cash Loading and FLM; and
- To allow LBP to focus on core functions and activities.

11.2 Subsequently, a new three-year contract was procured and awarded to the same SP at a cost of P324,000,000.00 covering the period August 7, 2016 to August 6, 2019.

11.3 The Bank is committed to provide a high 24/7/365 availability to its customers. The SP is therefore expected to keep the ATM's downtime to a minimum level. An "ATM downtime" means the machine is not available to the user for whatever reason, except for several pre-determined exclusions. For this purpose, the contract requires the SP to maintain ATM availability at 96 per cent within six months from the start of the engagement. To achieve this requirement, the SP has to conduct an average of five cash loadings/cash replenishments and an average of seven FLMs per ATM unit per month. The contract also provides penalty to the SP by way of monetary fines for failure to provide the required services and output.

ATM availability

The SP could not regularly maintain the required ATM availability rate despite the regular notification by ACMD.

11.4 The ATM Monitoring Division (AMD), the central monitoring unit of all LBP ATMs, was tasked to conduct real time 24/7 monitoring and assessment of the ATM's availability/uptime, downtime and cash level status of all LBP ATMs nationwide including those serviced by the SP. Based on the analysis of the Service Provider ATM Servicing Availability Reports prepared by AMD from January to December 2016, the performance efficiency of the SP was on a downward trend, as shown in the table below:

G4S ATM SERVICING AVAILABILITY REPORT - Jan-Dec. 2016 Summary

COVERING PERIOD	TOTAL NUMBER OF ATM	TOTAL AVAILABLE TIME* (IN HOURS)	TOTAL INFLUENCEABLE DOWNTIME**										ACTUAL ATM EQUIPMENT ESTATE AVAILABILITY/ UPTIME***	
			FIRST LEVEL MAINTENANCE (FLM) / ATM UNIT/HARDWARE PROBLEMS						OUT OF CASH		TOTAL DOWNTIME (IN HOURS)	PERCENT (%)		
			CARD READER		DISPENSER	Balancing Discrepancy (Shortage/ Overage)	ELECTRONIC JOURNAL	CHECK /RESET ATM	(IN HOURS)	PERCENT (%)			HOURS	PERCENT (%)
Jan. 1-31, 2016	279	195836.00	202.90	0.00	4710.54	6.97	0.00	1548.36	1088.63	14.40%	7557.40	3.86%	188278.60	96.14%
Feb. 1-28, 2016	280	182711.00	154.61	0.00	4314.12	0.00	0.00	1379.76	1687.48	22.39%	7535.97	4.12%	175175.03	95.88%
Mar. 1-31, 2016	282	194756.00	190.48	0.00	4970.98	0.00	0.00	1148.33	1673.53	20.96%	7983.32	4.10%	186772.68	95.90%
Apr. 1-30, 2016	283	189506.00	171.30	0.00	4519.52	0.00	0.00	1085.66	2612.31	31.14%	8388.79	4.43%	181117.21	95.57%
May 1-31, 2016	282	193754.00	375.89	0.00	5985.26	0.00	0.00	1704.91	6756.13	45.58%	14822.19	7.65%	178931.81	92.35%
Jun. 1-30, 2016	282	186345.00	209.22	0.00	7405.96	0.00	0.00	1306.83	4587.05	33.96%	13509.06	7.25%	172835.94	92.75%
Jul. 1-31, 2016	283	193141.00	393.73	0.00	6527.83	0.00	0.00	1265.12	5247.34	39.06%	13434.02	6.96%	179706.98	93.04%
Aug. 1-31, 2016	285	193811.00	398.24	0.00	4295.96	0.00	0.00	1554.97	3648.54	36.86%	9897.71	5.11%	183913.29	94.89%
Sept. 1-30, 2016	286	187706.00	377.95	0.00	4336.24	0.00	0.00	1285.17	3139.85	34.36%	9139.21	4.87%	178566.79	95.13%
Oct. 1-31, 2016	289	195223.00	513.14	0.00	6877.88	0.00	0.00	1031.05	1662.29	16.48%	10084.36	5.17%	185138.64	94.83%
Nov. 1-30, 2016	290	190853.00	380.93	0.00	8494.54	0.00	0.00	698.38	5982.49	38.46%	15556.34	8.15%	175296.66	91.85%
Dec. 1-31, 2016	292	198982.00	870.40	0.00	9609.26	0.00	0.00	1118.83	5898.75	33.71%	17497.24	8.79%	181484.76	91.21%
		2302624.00	**4238.79**	**0.00**	**72048.09**	**6.97**	**0.00**	**15127.37**	**43984.39**	**30.61%**	**135405.63**	**5.87%**	**2167218.37**	**94.13%**
			3.13%		53.21%	0.01%		11.17%	32.48%					

11.5 Except for the month of January 2016, the SP failed to maintain the ATM Service Availability Target Rate of 96 per cent. It also revealed the inverse relationship between the SP's efficiency and the number of ATMs being serviced. From 279 ATMs in January 2016 to 292 ATMs in December 2016, the availability of the ATMs to the customers of the Bank dropped from as high as 96.14 per cent in January 2016 to as low as 91.21 per cent in December 2016. On the other hand, the downtime hours of the ATMs increased from 3.86 per cent in January 2016 to 8.79 per cent in December 2016. Further, the table also shows that the major causes of downtime incidents were: a) dispenser problems/resetting activities due to machine hanging problems at 53.21 per cent and b) out-of-cash at 32.48 per cent.

11.6 The ATM Cash Management Department (ACMD) of the Bank was responsible for regularly monitoring the daily off-line status of outsourced ATMs and in notifying the SP on the status of outsourced ATMs. Despite notification from ACMD, the SP had continuously fell-short in providing prompt contracted services within two hours upon receipt of downtime notification from the Bank. The following table, sourced from ACMD's Schedule of Offline Daily Status Report Responded Beyond Two Hours, shows the numerous occurrences of ATM problems that were not attended/ responded by the SP for several hours/days during the sampled months of January, May, August, November, and December 2016.

LBP ATM Problems	January 2016	May 2016	August 2016	November 2016	December 2016	Total
Dispenser Fault	129	466	327	415	503	1840
Cash Low/For Cash Loading	53	267	95	383	301	1099
Cassette Fault	183	171	113	122	80	669
Diebold Servicing - SLM/Defective Shutter/Disaligned extractor belt	97	133	133	8	117	488
Out Session	169	151	142	0	0	462
Port Disconnected	0	0	16	98	95	209
Admin Card initialization	4	47	55	28	56	190
Line Problems-Globe, PLDT, Telecom	12	45	23	53	33	166
Card reader error	4	11	0	34	58	107
Card jammed/Card cannot be returned	6	0	40	11	6	63
Presenter Problem	1	0	39	20	0	60
Telecom fault/PLDT/ICC	25	0	15	0	19	59
Fraud device detected	1	4	9	11	22	47
For Migration	14	11	19	0	0	44
Diebold Latch Pin/many captured transactions/Software problems	0	6	0	33	0	39
Blank Screen	2	9	9	6	8	34
ATM won't boot	0	0	0	22	0	22
Mini IT Disaster Recovery Drill	0	17	0	0	0	17
Brown -Out at Site	0	4	8	0	0	12
Divert cassette fault	0	0	0	12	0	12
Diebold EPP not initialized	0	0	0	9	0	9
Cannot load	0	0	0	9	0	9
Diebold can't log on	0	0	0	7	0	7
Hanging Status	0	6	0	0	0	6
No transaction	0	0	0	5	0	5
Keypad problem	4	0	0	0	0	4
Site not accessible	0	0	0	3	0	3

LBP ATM Problems	January 2016	May 2016	August 2016	November 2016	December 2016	Total
No Permit	2	0	0	0	0	2
Total	**706**	**1348**	**1043**	**1289**	**1298**	**5684**

11.7 As provided under the contract, the SP had been penalized accordingly for its shortcomings in the performance of its contractual work in the total amount of P619,969.97 for CY 2016. Though the Bank was able to collect fines from the SP as penalty for not providing the required services and maintaining the committed level of ATM availability, it is not commensurate to the growing customers' dissatisfaction over the LBP's ATM services due to frequent and prolonged off-line and out-of-cash status. Further, random inquiries with the customers/clients of LBP Plaza branch revealed that the ATMs managed by the SP have longer downtime than the one maintained by the branch. While the responsible offices of the Bank may not have been remiss in performing their duties and responsibilities as required in the contract, the SP, in most cases, was not able to deliver the prompt response to the ATM problems. It showed that the ATM availability did not improve under the services of the SP.

Cash loading

Allowing the SP complete control in determining the manner, time, date and the ATM units to be replenished had contributed to the inefficient replenishment of the ATMs.

11.8 Using the International Switching Technology (IST), the AMD can monitor and check the current state/activities of the ATMs of the Bank. AMD is operating 24/7 and its personnel work three shifts a day to oversee the ATM status of the Bank and coordinate the ATM breakdowns for immediate resolution. For cash level status, AMD sends to the SP the ATM cash level at 4 AM and 1 PM daily. Once the system displays a "Cassette Low" status, meaning low cash status, AMD will inform the SP thru e-mail. If the current state of the ATM in the system still does not change regardless of the advice, AMD will make a follow-up either by phone or by sending a ticket via e-mail.

11.9 Since AMD's cash level notification is continuous, the SP can easily identify the ATM that would require immediate action. In the event the ATMs reached the Cassette-Low status, the SP will receive another advice from AMD reiterating the notification. AMD will repeat the process until the IST displays an online status for the ATM. Hence, the SP is furnished with timely information on the status of ATMs

11.10 Records showed that during the implementation of the contract, the SP regularly incurred delays in replenishing the ATMs. For CY 2016, AMD reported an availability rate lower than 90 per cent on the following dates:

Date	Downtime (ATM Out-of-Cash)		Total Uptime Percentage	No. of ATMs "Out-of-Cash"
	Hours	Percent		
16-Dec-16	707.02	10.86	89.14	63
17-Dec-16	1,038.54	16.68	83.32	74
24-Dec-16	639.41	10.20	89.80	51
17-Nov-16	732.52	11.33	88.67	65
19-Nov-16	735.63	11.90	88.10	68
20-Nov-16	736.63	11.92	88.08	50
21-Nov-16	668.39	10.34	89.66	52

Date	Downtime (ATM Out-of-Cash)		Total Uptime Percentage	No. of ATMs "Out-of-Cash"
	Hours	Percent		
17-May-16	703.94	11.05	88.95	72
18-May-16	810.57	12.86	87.14	80
19-May-16	637.31	10.11	89.89	56

11.11 The Replenishment Report of the SP showed that some ATMs were loaded twice on the same day. This was done at different intervals as confirmed from the branches. Inquiry with the branch also revealed that they would call ACMD just to remind the SP to load the ATMs twice during paydays and holidays because of the volume of cash withdrawals by the clients.

11.12 Detailed verification of the Replenishment Report against Forecast Plan and ATM Daily Status Report of ACMD disclosed several reasons on how the ATMs reached the out-of-cash-status that resulted in fluctuating availability rates of ATMs, as follows:

a. Some of the ATMs forecasted to be replenished for the day were cancelled per Cancelled Replenishment;

b. ATMs were left unattended by the SP for several days even with the timely and repetitive notification of the cash level status of AMD per ATM Daily Status Report; and

c. Inconsistencies on the action of the SP in performing its duties. While some ATMs were replenished twice on the same day per Replenishment Report other ATMs were left not replenished especially during peak season, such as paydays, weekends, and holidays as reported in the Availability Report.

11.13 Though the employment of the Forecast Plan, which is based on historical transaction of the Bank, was provided in the Agreement, it could not precisely estimate the daily cash level status of each ATM in real time. This limitation has contributed to the out-of-cash status of numerous ATMs. Having real-time monitoring of the ATMs, the ACMD notifications of the cash level status of the ATMs should have been given precedence during cash replenishment.

11.14 The Bank could not fully address this situation because the contract allowed flexibility to the SP. The SP has complete control, particularly in cash loading activities, in determining the manner, time, date and the ATM units to be replenished. The agreement also allows the SP to retain the retrieved cash from ATMs and utilize it for onward replenishment.

Despite the availability of cash on hand, the SP was not able to replenish all the ATMs that need to be loaded.

11.15 The SP utilizes a cash forecasting tool in preparing its ATM replenishment plan (RP). The RP is being submitted to the Bank two days before the actual cash loading schedule. All in all, it would generally take a minimum of three days to replenish an ATM machine under the services of the SP, in contrast to the ATMs under the maintenance of the Bank, which were being replenished upon reaching the threshold amount set in the Branch Operations Manual of LBP. There are ATMs in need of immediate replenishment but cannot be serviced because these were not included in the RP, notwithstanding the available cash on hand of the SP as shown in the table below:

Transaction Date	Beginning CIV Balance, per DCSR (A)	Cash Collected from LBP-ACMD (B)	ATM Retrieval (C)	TOTAL Cash Available for ATM Loading (A+B+C) (D)	Actual ATM Replenishment (E)	Cash Left after ATM Loading (D-E)
12/01/16	1,107,614,800.00	464,000,000.00	141,608,800.00	1,713,223,600.00	331,800,000.00	1,381,423,600.00
12/02/16	1,034,953,200.00	246,000,000.00	243,250,500.00	1,524,203,700.00	462,000,000.00	1,062,203,700.00
12/03/16	1,062,203,700.00		174,362,100.00	1,236,565,800.00	340,200,000.00	896,365,800.00
12/04/16	896,365,800.00		101,298,100.00	997,663,900.00	208,000,000.00	789,663,900.00
12/05/16	1,062,203,700.00	131,000,000.00	205,109,700.00	1,398,313,400.00	344,400,000.00	1,053,913,400.00
12/06/16	781,373,600.00	250,000,000.00	197,684,200.00	1,229,057,800.00	365,400,000.00	863,657,800.00
12/07/16	863,657,800.00	219,000,000.00	173,557,100.00	1,256,214,900.00	319,200,000.00	937,014,900.00
12/08/16	937,014,900.00	319,000,000.00	184,576,700.00	1,440,591,600.00	323,400,000.00	1,117,191,600.00
12/09/16	1,117,191,600.00	166,000,000.00	204,379,600.00	1,487,571,200.00	378,000,000.00	1,109,571,200.00
12/10/16	1,109,571,200.00		103,646,500.00	1,213,217,700.00	340,200,000.00	873,017,700.00
12/11/16	873,017,700.00		95,262,700.00	968,280,400.00	252,000,000.00	716,280,400.00
12/12/16	1,109,571,200.00	186,000,000.00	137,218,700.00	1,432,789,900.00	289,800,000.00	1,142,989,900.00
12/13/16	749,699,100.00	446,000,000.00	166,579,700.00	1,362,278,800.00	315,000,000.00	1,047,278,800.00
12/14/16	1,054,903,500.00	260,000,000.00	150,032,300.00	1,464,935,800.00	340,200,000.00	1,124,735,800.00
12/15/16	1,124,735,800.00	270,000,000.00	146,619,800.00	1,541,355,600.00	327,600,000.00	1,213,755,600.00
12/16/16	1,213,755,600.00	129,000,000.00	92,364,000.00	1,435,119,600.00	277,200,000.00	1,157,919,600.00
12/17/16	1,157,919,600.00		60,620,100.00	1,218,539,700.00	344,400,000.00	874,139,700.00
12/18/16	874,139,700.00		103,206,700.00	977,346,400.00	411,600,000.00	565,746,400.00
12/19/16	1,157,919,600.00	103,000,000.00	107,663,900.00	1,368,583,500.00	247,800,000.00	1,120,783,500.00
12/20/16	528,610,300.00	490,000,000.00	59,422,600.00	1,078,032,900.00	197,400,000.00	880,632,900.00
12/21/16	880,633,700.00	235,000,000.00	161,828,600.00	1,277,462,300.00	466,000,000.00	811,462,300.00
12/22/16	811,462,300.00	432,000,000.00	137,169,800.00	1,380,632,100.00	386,400,000.00	994,232,100.00
12/23/16	994,232,100.00	377,000,000.00	147,498,200.00	1,518,730,300.00	394,800,000.00	1,123,930,300.00
12/24/16	1,123,930,300.00		81,699,900.00	1,205,630,200.00	306,600,000.00	899,030,200.00
12/25/16	899,030,200.00		161,177,100.00	1,060,207,300.00	394,800,000.00	665,407,300.00
12/26/16	665,407,300.00		176,821,500.00	842,228,800.00	310,800,000.00	531,428,800.00
12/27/16	1,123,930,300.00	329,000,000.00	94,974,300.00	1,547,904,600.00	159,600,000.00	1,388,304,600.00
12/28/16	795,582,000.00	453,000,000.00	155,900,200.00	1,404,482,200.00	294,000,000.00	1,110,482,200.00
12/29/16	1,110,482,200.00	284,000,000.00	186,585,100.00	1,581,067,300.00	445,200,000.00	1,135,867,300.00
12/30/16	1,135,867,300.00		140,805,800.00	1,276,673,100.00	529,200,000.00	747,473,100.00
12/31/16	747,473,100.00		167,673,200.00	915,146,300.00	344,400,000.00	570,746,300.00

- No cash pick up from Land Bank on Saturday, Sunday and holidays
- Cash left for ATM Loading has no relation to the Beginning CIV balance. Other transactions affecting the CIV were not captured in the illustration to simplify the presentation.

11.16 It was also observed that the SP has ample volume of cash kept inside the vault but was not able to respond promptly to AMD's notification resulting in several LBP ATMs that are out-of-cash, as shown in the selected samples below:

Days	Available Cash Balance for the Day After the Scheduled ATM Loading	Number of ATMs Still Out-of-Cash per Daily Status Report	Amount that needs to be loaded to Out-of-Cash ATMs
16-Dec-16	1,157,919,600.00	63	264,600,000.00

Days	Available Cash Balance for the Day After the Scheduled ATM Loading	Number of ATMs Still Out-of-Cash per Daily Status Report	Amount that needs to be loaded to Out-of-Cash ATMs
17-Dec-16	874,139,700.00	74	310,800,000.00
24-Dec-16	899,030,200.00	51	214,200,000.00
17-Nov-16	494,159,900.00	65	273,000,000.00
19-Nov-16*	640,409,200.00	68	285,600,000.00
21-Nov-16	507,947,900.00	52	218,400,000.00
17-May-16	578,210,700.00	72	302,400,000.00
18-May-16	536,094,600.00	80	336,000,000.00
19-May-16	656,017,900.00	56	235,200,000.00

*November 19 & 20 falls on Saturday & Sunday, balances of the last working day was used.

11.17 In these cases, the Bank could only advice the SP of the situation but could not compel them to make the necessary replenishment, due to contractual limitation. Moreover, the Forecast Plan, which is based on historical transaction of the Bank, could not precisely estimate the daily cash level status of each ATM in real time. This limitation has contributed to the out-of-cash status of numerous ATMs.

The contract allows the Service Provider to use the retrieved cash for onward replenishment, retaining in its custody substantial amount of cash that can earn interest for the Bank if placed in overnight cash facility.

11.18 Based on the TOR and other related contract documents, the cash that the Service Provider retrieved from an ATM and those that are not loaded will remain in its custody for onward replenishment.

11.19 In our evaluation, we noted that the daily cash retrieved from ATM and those that that were not loaded were quite substantial, thereby, allowing the SP to retain significant amount of cash than what is needed for replenishments.

11.20 In relation to the data presented in the table under paragraph 11.16, had the SP been required to return to LBP the retrieved and unutilized cash under the contract, the money could have been invested in the BSP Overnight Cash Facility and LBP could have earned interest income of more or less P15,590,762.00 in CY 2016. This is based on assumption that all unused CIV at the end-of-day shall be returned to LBP.

11.21 Management however, informed that the SP maintains in its CIV at the end-of-the day available cash for three-day loading. There is no agreed threshold amount, however, in the contract or TOR for the three-day buffer stock in the SP's CIV. Thus, there is no benchmark for the determination of the reasonableness of the amount of cash retained in the CIV of the SP at the end of the day

11.22 Management further explained that as stated in the contract, the cash retrieved by the SP can be used for onward replenishments. ACMD carefully evaluates the reasonableness of the volume of cash requested based on the list of forecasted ATMs scheduled for replenishment identified by the SP to avoid overstocking of cash at its vault. In addition, ACMD also considers the projected amount of cash retrieval and deducts the projected amount from the cash order. If the Bank will require the SP to return all the retrieved cash, the process seems inefficient as this will entail additional workload to ACMD staff because of sorting/counting/balancing activities and at the end of the process, the cash retrieved will again be released to the SP.

11.23 Management informed that the Bank has implemented a three-day buffer and said that they have a document of the six-month actual cash retrieval, averaging the same in order to determine the percentage of the threshold. They will then compare this to the SP's request for cash.

Contract termination

11.24 In like manner, despite the amount of penalties it paid, the SP continued incurring delays in providing FLM services. In this regard, the contract's Terms of Reference (TOR) has provided a basis for contract termination due to incessant violation, as shown below:

> "The Bank reserves the right to cancel or terminate the contract after a 90 days' notice for the following reasons:
>
> a. The services are found to be unsatisfactory and there is a consistent failure to maintain the Service Level Agreement (SLA) for six (6) consecutive months;
>
> b. The overall average availability of all ATMs in the network falls below 90% for three consecutive months (an initial notice to rectify will be sent) and after a further three consecutive months for rectification is issued and no improvement occurs, a final notice to terminate will be sent."

11.25 Based on the table presented in paragraph 11.4, the SP had consistently failed to maintain the SLAs for six consecutive months. However, the overall average availability of all ATMs in the network never falls below 90 per cent. This might be the reason why the SP were able to continuously and consistently perform below the required total uptime maintenance rate of 96 per cent without being faulted and without causing the rescission of the contract. With the significant amount of the Bank's cash entrusted to the SP and the reputation of the Bank at stake, the above-mentioned provision may be considered lenient to the SP.

11.26 The Bank had required ATM availability of not lower than 90 per cent service level for three consecutive months before it can be declared at fault, or be considered for rescission of contracts, which is attainable by SP. However, ten per cent of the ATMs are unavailable; which is disadvantageous to the Bank and to the depositors/customers. Unless amended, this particular provision is susceptible to abuse.

11.27 **We recommended that Management revisit the Contract Agreement and the corresponding TOR to consider the following:**

> **a. Allow emergency replenishment of ATMs that are not included in the replenishment plan upon directive of the Bank;**
>
> **b. Impose stringent sanctions and study the possibility and viability that onsite ATMs currently outsourced to the SP be turned over and be managed by the Bank; and**

c. Set a threshold or limit to the amount of retrieved and unutilized cash that can be used for onward replenishment to determine the reasonableness of the amount of cash in the custody of the Service Provider at the end of the day.

11.28 Management informed that:

a. All concerns of the branches were regularly discussed during their monthly service meeting with the SP. Also, a continuous monitoring on the SP's operations are being conducted to further improve the response time in FLM and cash loading activities and to mitigate the complaints from clients and branches. Starting January 2017, the Bank implemented the daily reconciliation of open FLM and Cash Loading tickets which contributed to an improved ATM uptime. The following are the uptime of ATMs handled by the SP for the first four months of 2017: 94.86 per cent, 96.23 per cent, 96.24 per cent and 94.83 per cent, respectively;

b. The Bank is currently implementing this type of "sanction" to the SP by reducing the number of onsite ATMs being serviced by them (e.g., Cash Department and Bicutan Branches). Since 2016, expansion of coverage outside of the NCR was also put on hold subject to attainment of at least "Satisfactory" rating from the branches covered by the engagement;

c. The setting up of cash threshold on the CIV of SP is not suitable particularly if it falls on payday/weekend/holiday when the volume of withdrawal is expected to be high;

d. The Bank is currently looking for a more sophisticated ATM Monitoring System that will integrate with the Cash Forecasting System of the SP to automate the Cash Forecasting Plan and the target implementation is by last quarter of 2017; and

e. Penalties were imposed to the SP for not meeting the Service Level Agreement.

11.29 As a rejoinder, we appreciate the continuous effort of the Bank in finding solutions for the improvement of the delivery of the outsourced services. While we agree with the initial action taken by management, it is still our view that the Bank needs to consider the possibility of managing all onsite ATMs. Further, the threshold to be set may be flexible to accommodate projected increase in withdrawals during peak season such as paydays/weekends/holidays. In spite of the penalties imposed by the Bank to the SP, the availability rate of ATMs has not improved. Hence, it is also worth considering the possibility of increasing the 90 per cent threshold as basis for the rescission of the contract.

Information Technology Risk Management

12. The increasing incidence of electronic fraudulent schemes, such as ATM skimming and unauthorized online purchases, and its impact to the general public were not captured for risk mitigation in the Risk Treatment Register, which can result in the accumulation of material financial losses, deterioration of Bank's reputation, and loss of public confidence.

12.1 The Bangko Sentral ng Pilipinas (BSP) issued Circular No. 808 Series of 2013, bearing on the subject "Guidelines on Information Technology Risk Management for All Banks and Other BSP Supervised Institutions", so as to provide guidance in managing risks associated with the use of technology. Section 1, §X176.7 of the Circular states that:

> "**§X176.7 IT Risk Management System (ITRMS).** As BSIs [BSP supervised institutions] become more dependent on IT systems and processes, technology risks and information security issues have become progressively more complex and pressing in recent years. Information security is just as important as the new technologies being installed by the BSIs. As progress in technology shifts to higher gear, the trend in cyber-attacks, intrusions, and other forms of incidents on computer systems shows that it will not only persist but will continue to increase in frequency and spread in magnitude.
>
> Management of IT risks and information security issues becomes a necessity and an important part of BSIs' risk management system. BSIs are therefore required to establish a robust ITRM system covering four (4) key components: 1.) IT governance, 2.) risk identification and assessment, 3.) IT controls implementation, and 4.) Risk measurement and monitoring."

12.2 In line with the BSP Circular No. 808, LBP adopted its ITRMS Framework under Executive Order (EO) No. 050, Series of 2015. This shall serve as a guide in managing risks associated with the use of technology in order to: (1) protect the Bank from adverse impact of IT risks, (2) comply with laws and regulations and provisions of industry-related control standards, and (3) minimize, if not totally avoid, IT risks as well as manage vulnerabilities to information systems and technology.

12.3 Also, LBP EO No. 039, Series of 2016, was issued to cover the procedures in the conduct of information security risk assessment and procedures in accomplishing the Information Security Risk Assessment Register (RAR) and Risk Treatment Register (RTR), and other supporting templates.

12.4 As part of IT risk identification and assessment, the Bank conducts regular risk assessment that drives response selection and controls implementation. The Business Units (BUs) are the risk owners and the Information System Technology Risk Management Office (ISTRMO) holds the risk oversight function.

12.5 The RAR & RTR templates are provided by ISTRMO to the BUs. The BUs identifies its assets and categorizes the assets whether it belong to information assets, physical assets, software, people or service. After categorization, BUs indicates the valuation of the assets and identifies the threats and vulnerabilities related to the assets. The RAR template that was provided by the ISTRMO calculates the total risk score based on the information provided by the BUs. An asset which has a risk score of "very low" and "low" will not be captured in the RTR while an asset which has a risk score of "moderate", "major" and "severe" will be considered for risk treatment in the RTR.

12.6 In our evaluation, however, it was noted that the risks of electronic fraudulent schemes, such as ATM skimming and unauthorized online purchase, and its impact to the general public are not captured for mitigation in the Risk Treatment Register (RTR) due to the reason that external attacks on ATMs were assessed as having a risk score of "low", hence, not subjected for risk treatment.

12.7 Records disclosed that a total of P42,169,386.38 unauthorized withdrawals was reported as of December 31, 2016, summarized as follows:

Nature	No. of Accounts	Amount	Percentage
Restituted accounts	791	P32,735,429.10	77.63
Accounts approved for restitution; awaiting final documentation	8	30,600.00	0.07
Disapproved accounts – not consistent with established indicators	218	5,519,205.06	13.09
Disapproved accounts due to EO No. 040	82	1,641,400.00	3.89
Other complaints	45	2,242,752.22	5.32
Total	**1,144**	**P42,169,386.38**	**100.00**

12.8 As shown above, although compromised with other banks, a total amount of P32.735 million or 77.63 per cent of the unauthorized withdrawals/online purchases have been restituted by LBP. This is a summation of the restituted amounts from 2013 to 2016. Statistics show that, except for the year 2015, an increasing trend of restituted unauthorized withdrawals/online purchases, P16.583 million or 51 per cent of which pertains to the year 2016, recapitulated below:

Year	No. of Accounts	Amount
2013	118	P 4,100,251.00
2014	118	7,043,513.00
2015	88	5,008,873.73
2016	467	16,582,791.37
Total	**791**	**P32,735,429.10**

12.9 In addition, in November 2016, there were 53 instances of unauthorized online purchases with a total amount of P893,628.96 that occurred in University of the Philippines (UP) Diliman Extension Office. The investigation report disclosed that all of the online purchases were done in France and affected cardholders were mostly students and employees of UP Diliman. It was alleged that some of the affected cardholders submitted a photocopy of their LANDBANK VISA Debit Card (LDVC) as part of their loan application with credit cooperatives. On the other hand, some specifically stated that they have not photocopied their ATM cards but their accounts were still used for unauthorized online purchases.

12.10 Initially, it was suspected that skimming devices were deeply inserted in the ATMs by fraudsters. However, the inspections conducted on November 9 and 15, 2016 yielded negative results as there were no traces of skimming devices/adhesives or any irregularity on the subject ATMs.

12.11 As reflected in the records, P528,838.12 of the total amount of unauthorized online purchases was restituted on January 18, 2017 while the remaining amount of P364,790.84 is still pending for restitution. As of this date, however, there are only limited investigation procedures that can be performed by the bank on credit cooperatives responsible for leaking the debit cards details.

12.12 Moreover, sometime in March 2017, the media reported that cases of skimming attacks of LBP depositors/clients' accounts in Cebu City happened. This affected dozens of LBP depositors/clients with at least 50 government employees, including a ranking police officer, a Regional Trial Court (RTC) judge, a retired RTC judge, and a prosecutor. It was informed that as of this date, full details of the incident are not available since the investigation is still on-going.

12.13 In view of the increasing incidence of fraudulent electronic schemes, the Bank is incurring material financial losses as a consequence of restituting the amounts deceitfully taken from the accounts of the affected depositors/cardholders. Similarly, being the largest government banking institution, receiving multiple awards in the local and international arena, and among the top ranking universal banks in the Philippines, these occurrences pose reputational risk to the Bank.

12.14 In order to prevent electronic fraudulent schemes, banks are required to provide easy to understand and prominent advice to its clients on security precautions for electronic services. This is required under item 4.3.3 of Appendix 75f of BSP Circular No. 808 series of 2013, which provides that:

> "4.3.3 **Consumer Awareness.** Customer education is a key defense against fraud, identity theft and security breach. Therefore, the BSI should pay special attention to the provision of easy to understand and prominent advice to its customers on security precautions for e-services. To be effective, the BSI should maintain and continuously evaluate its consumer awareness program…"

12.15 With the rising occasions of electronic fraudulent schemes, it may be said that the consumer awareness program of the Bank, particularly on the risk associated to the exposure of debit card numbers and other sensitive debit card details, might not be widely disseminated to the customers. The statistics shown on the increasing trend of unauthorized withdrawals as presented in paragraph 12.8 where cards were compromised on other banks amounting to P32,735,429.10 as of December 2016 and was restituted by LBP proved that the customer awareness program needed improvement.

12.16 The occurrence of the above-mentioned electronic fraudulent schemes would show that LBP, while coping with the recent changes in technology and latest electronic trends in banking industry, still need to strengthen its information security measures to ensure that account/card holders' sensitive information are not breached, to conform to the directive of the BSP under Appendix 75f, item 3.3, of BSP Circular No. 808, series of 2013, which states that:

> "The BSI should adjust or update, as appropriate, its information security program in the light of any relevant changes in technology, the sensitivity of its customer information and internal or external threats to information. The BSI should ensure that the related information security measures and internal control are installed, regularly updated, monitored and are appropriate with the risks associated with their products and services."

12.17 **We recommended and Management agreed to:**

a. Revisit the risk assessment for electronic fraudulent schemes and its potential impact so as to make the necessary actions for risk mitigation;

b. Remind the BUs and the ISO to consider historical occurrences and potential threats that may put the bank at risk. Being the key personnel in maintaining information security of the Bank, the ISO along with Technology Management Group (TMG) and Card and eBanking Group (CeBG) are recommended to work on solutions to effectively manage the risks and prevent them from occurring;

c. Continuously evaluate and enhance the consumer awareness program. Adopt strategies in disseminating easy to understand advices and security precautions for e-services so that the Bank clients will pay special attention in protecting their valuable and sensitive information encrypted in the cards; and

d. Perform sufficient investigation procedures to determine the cause and origin of electronic fraudulent schemes so as to aid in strengthening the existing IT security.

12.18 Management added that the results of chargeback from VISA indicates the information of the person who made the online purchases such as the name, billing address, telephone number, e-mail address and delivery address. The said information are cascaded to the Branch to verify whether the person who made the online purchases was the one who took the photocopy of the ATM card or was known by the client. Reported incidents are used as basis in improving the Guidelines on Handling Complaints on Alleged Unauthorized ATM Withdrawals to include unauthorized POS and online transactions.

12.19 Since the information security risk assessment conducted by branches is primarily devised to present potential risks based on historical losses and projected risk occurrences (**2016 InfoSec RAR & RTR were forwarded to branches in November 2015)**, it will not be able to capture incidents that happened in the latter part of 2016. Hence, branches can use the actual losses involving unauthorized withdrawals in 2016 and early 2017 as reference in their 2017 assessment.

12.20 As a rejoinder, stringent investigations are recommended to be performed by Management to be able to determine the cause and origin of electronic fraudulent schemes in order to mitigate or avoid the instances of electronic fraudulent schemes to happen and possibility of shifting the burden of loss to the party responsible of the crime. The fact that there is a limited investigation procedures that can be performed by the bank on credit cooperatives responsible for leaking the debit cards details, the Management can seek assistance from the National Bureau of Investigation (NBI) to do the investigation, thus gaining confidence that sufficient procedures were performed.

13. Delayed preparation and reporting of the results of Information Security Risk Assessment (ISRA) to Management resulted in the inability to project future information security risks within the prescribed period in order to come up with timely risk strategies appropriate for the Bank's business requirements.

13.1 Items F.5.a and F.9 of LBP EO No. 039, Series of 2016, provides:

> "F. GENERAL GUIDELINES:
> xxx
>
> 5. Frequency of Assessment and Submission of Risk Assessment Register (RAR) and Risk Treatment Register (RTR):
>
>   a. InfoSec risk assessment and accomplishments of InfoSec RAR and RTR shall be done on an annual basis. Risk assessment for the succeeding year shall be conducted on the third quarter of the current year (e.g., InfoSec assessment for the calendar year 2016 shall be conducted in September 2015)."
>
> xxx
>
> 9. ISTRMO [Information Security and Technology Risk Management Office] shall report the result of InfoSec risk assessment to the Sector Head concerned prior to presentation to the Management Committee (ManCom) and Risk Oversight Committee (RiskCom)…"

13.2 However, verification of records showed that the consolidated bank-wide ISRA for the year 2016 was not yet finalized as of March 16, 2017 which was not in accordance with the above-cited Guidelines on Frequency of Assessment and Submission of RAR and RTR.

13.3 Also, it was noted that there were delays in the dissemination of RAR and RTR templates for the year 2017 which was done only in the month of February 2017. In effect, it would delay the preparation of overall risk assessment for the year 2017.

13.4 Thus, LBP could not project future information security risks within the third quarter of the current year in order to come up with strategies to address the risks appropriate for the Bank's operations in the succeeding year.

13.5 **We recommended and Management agreed to:**

a. Prepare the ISRA in accordance with the timeline provided under LBP Executive Order No. 039, Series of 2016, to come up with timely risk strategies appropriate for the Bank's business requirements, and

b. Require the Business Units to submit to the Sector Head concerned the accomplished ISRA on time to facilitate timely consolidation and finalization.

14. Delayed compliance with the BSP directives to migrate from magnetic stripe technology to Europay, Mastercard & VISA (EMV) technology for ATMs, Point of Sale (POS) terminals and payment cards increases vulnerabilities of skimming attacks that might result in potential losses.

14.1 Section 1, §X176.7, Item 3.e, bullet point 3 of the BSP Circular No. 808 series of 2013 states that:

> "ATMs, POS terminals and payment cards are also vulnerable to skimming attacks due to the lack of deployment of globally recognized EMV enabled technology by BSIs. Magnetic stripe only ATMs, POS terminals and cards are largely defenseless against modern fraud techniques. Therefore, all concerned BSIs should shift from magnetic stripe technology to EMV chip enabled cards, POS terminals and ATMs. The entire payment card network should be migrated to EMV by January 01, 2017. This requirement shall cover both issuing and acquiring programs of concerned BSIs. A written and Board approved EMV migration plan should be submitted to BSP within six (6) months from date of this Circular. Likewise, the detailed guidelines covering subject EMV requirement shall be issued separately."

14.2 As part of IT Controls Implementation, LBP has adopted mitigation procedures for electronic fraudulent schemes such as the implementation of end to end Triple DES (3DES) encryption standards for the whole ATM Network.

14.3 However, the Bank has not yet complied with the BSP directives to migrate from magnetic stripe technology to EMV chip enabled cards, POS terminals and ATMs. As such, LBP issued ATM/debit/credit cards are still vulnerable to skimming attacks. This situation poses risk in increasing financial losses that will be borne by the Bank should customers fall prey to fraudsters.

14.4 **We recommended that Management prioritize the implementation of the EMV technology for the entire payment card network for better customer satisfaction and reduction of potential financial losses.**

14.5 Management explained that the EMV Project of the Bank started in 2014. This initiated the replacement of the ATM Host in order to meet the standards of EMV. To date, the ATM Host is expected to go live by June 2017. Distribution of EMV chip cards is expected to start by August 2017.

14.6 As a rejoinder, while the EMV Project of the Bank started in 2014, the Bank has not yet complied with the BSP directives requiring that the entire payment card network should be migrated to EMV by January 01, 2017. This poses risk in increasing financial losses that will be borne by the Bank should customers fall prey to fraudsters.

14.7 We, therefore, maintain our recommendations and encourage Management to prioritize the implementation of the EMV technology for the entire payment card network for better customer satisfaction and reduction of potential financial losses.

Foreign Securities Trading

15. The existing LBP general guidelines on trading securities did not include directions in handling the changes in the bank's trading strategy for the day to mitigate the risk of improper market conduct practices and non-observance of the securities regulation.

15.1 Under Title VII - Prohibitions on Fraud, Manipulation and Insider Trading of the 2015 Implementing Rules and Regulations of the Securities Regulation Code (Republic Act 8799) provides that:

> "Rule 24.1 (a and b) - Manipulative Practices
>
> 24.1.1. It shall be unlawful for any person acting for himself or through a dealer or broker, directly or indirectly:
>
> 24. 1. 1. 1. To create a false or misleading appearance of active trading in any listed security traded in an Exchange or any other trading market (hereafter referred to purposes of this Chapter as "Exchange"):
>
> 24.1.1.1.1. By effecting any transaction in such security which involves no change in the beneficial ownership thereof;
>
> 24.1.1.1.2. By entering an order or orders for the purchase or sale of such security with the knowledge that a simultaneous order or orders of substantially the same size, time and price, for the sale or purchase of any such security, has or will be entered by or for the same or different parties; or
>
> 24.1.1.1.3. By performing similar act where there is no change in beneficial ownership."

15.2 Manipulation is defined as a series of transactions designed to raise or lower a price of a security or to give the appearance of trading for the purpose of inducing others to buy or sell.

15.3 Examination of the trading transactions of foreign securities from January to December 2016 revealed that an aggregate amount of US$21.500 million of both purchases and sales of foreign securities matched each other in price, volume and date of transaction, and involved no change in counterparty. The details are presented in Annex 1.

15.4 These unusual foreign trading transactions, if not properly controlled, could progress into a form of manipulation considering the presence of essential elements such as: a) a series of transactions in a security, and b) designed to raise or lower the security's price or to give the appearance of trading, which are existing as shown by the series of transactions that constitute not less than three consecutive purchases of security; and matched purchase and sale of foreign trading transactions.

15.5 Evaluation showed that while the amount of unusual foreign trading transactions represented only one per cent of the total foreign trading transactions of the Bank for CY 2016, the presence of the essential elements of manipulation can trigger improper market conduct practices.

15.6 Management explained that the unusual trading transactions cited are results of normal and natural consequence and are purely coincidental. Since U.S. Treasuries are traded actively and heavily, the risk of an open position will opt to square the position to break even, cut loss or change view as reaction to market news and development.

15.7 Management further explained that the foreign securities trading transactions cited are distinct and isolated cases with no observable pattern and that an intention to manipulate market would entail a series of coordinated and frequent trades within a short span of time requiring huge volume (i.e., beyond USD 100 Million). Management also informed that the bank is but an institutional client of the primary dealers and as such can only accept the prevailing prices in the U.S. Treasury market and is not capable of affecting the market price.

15.8 Management also emphasized that:

1) LANDBANK have a limited number of Board-approved counterparties for U.S. Treasury securities transactions;

2) The observed unusual foreign securities trading transactions are normal in nature under the USD 13 Trillion U.S. Treasury market environment; and

3) The Unit concerned acted in good faith, with no intention of manipulating the U.S. Treasury market which it has totally no influence thereof.

15.9 It was, however noted that trading strategy for daily activities is prepared which the global financial market interest rates and economic data are considered, thus the occurrence of unusual foreign trading transactions demonstrate change in strategy considering that the trading transactions occurred within a few minutes from each other. The details are presented in Annex 2.

15.10 Taking into account that there is a change in view/strategy for a day due to current global market news and developments which prompted the trader to square the Bank’s position; however this flexibility or discretion to change the strategy was not documented or governed by the Bank’s policy and guidelines.

15.11 Furthermore, we found out that there is existing LBP Guidelines on Monitoring and Reporting Matched Trade Transaction under the Executive Order No.37, Series of 2016; however the guidelines did not include the monitoring and reporting of matched trade transactions that resulted from trading in foreign securities entered by the Bank.

15.12 Thus, while it is recognized that the Bank's volume of the foreign securities trading transactions is not significant to influence the market price of the foreign securities at present, there is a possibility that the volume of the foreign securities transactions of the Bank will increase in the future. Hence, it is our view that it would be a sound business practice that guidelines be put in place and documented to ensure that the foreign securities trading transactions are properly executed.

15.13 **We recommended and Management agreed to revisit the LBP Guidelines on Monitoring and Reporting Matched Trade Transactions and include the foreign securities trading to ensure proper market conduct practices and compliance with the securities regulation.**

Official Development Assistance (ODA) funded loan program

16. The Agricultural Credit Support Project (ACSP) fund posted a utilization rate of 71.52 per cent due to lack of effective marketing strategies and technical assistance to beneficiaries resulting to payment of P18.725 million in commitment fees as at December 31, 2016.

16.1 The ACSP program was aimed to support the National Government's goal of poverty reduction and it provides credit and non-credit support to agriculture and agri-related projects that may need additional capital to increase production or expand operations. The credit component provides loans to eligible Small and Medium Enterprises (SMEs) and Large Agri-business Enterprises LAEs, while the non-credit component provides technical and capacity-building assistance to ACSP implementers and borrowers.

16.2 Two of the ACSP's objectives are as follows:

a. To increase investment, create new job opportunities and improve agricultural productivity in the rural areas by providing credit assistance to Small Farmers and Fisherfolk (SFF) groups, Small and Medium enterprises (SMEs), Large Agri-business Enterprises (LAEs) and Participating Financial Institutions (PFIs); and

b. To increase the availability of loanable fund to its priority sectors…

16.3 The ACSP Implementing Guidelines under LBP Executive Order (EO), specifically item No. H.4 of LBP EO No. 030, provides that *Lending Centers/Units (LCs/LUs) shall:*

a. Handle the marketing and promotion of the ACSP with the assistance of PMD I;
b. Identify loan accounts which may qualify under the program;
c. Evaluate loan accounts and secure loan documents necessary for approval of ACSP funding/reimbursement;
xxx

LBP Branches shall:

a. Assist in the marketing and promotion of ACSP; and

b. Endorsed prospective clients to concerned LUs. xxx

16.4 As at December 31, 2016, the utilization rate of the ACSP fund was only 71.52 per cent and the total commitment fees paid amounted to P18.725 million. Also the estimated annual fund requirement of 99.65 per cent for relending to sub-borrower as of CY 2014 as provided under Section 2, Schedule 1 of the Loan Agreement was not attained. Comparative data is shown as follows:

Year	Project cost for Relending (JPY) per Sec.2, Schedule 1 of the Loan Agreement	Actual Availment/ Utilization in JPY	Variance	Estimated Availment/ Utilization Rate	Actual Availment/ Utilization Rate	Rate Variance	Actual Commitment Fees Paid in Peso
2010	1,479,000,000		1,479,000,000	10.12%			
2011	2,245,000,000		2,245,000,000	15.37%	99.65%		
2009-2011	3,724,000,000	6,099,813,504	2,375,813,504	25.49%	41.76%	16.27%	5,659,705.69
2012	4,304,000,000	1,734,587,643	2,569,412,357	29.46%	11.87%	17.59%	4,051,814.44
2013	4,344,000,000	976,784,740	3,367,215,260	29.74%	6.69%	23.05%	2,825,833.11
2014	2,185,000,000	749,061,423	1,435,938,577	14.96%	5.13%	9.83%	2,294,590.45
2015	51,000,000	291,162,565	240,162,565	0.35%	1.99%	1.64%	1,883,923.84
2016	0	595,346,068	595,346,068	0.00%	4.08%	4.08%	2,008,670.16
	14,608,000,000	10,446,755,943		100.00%	71.52%	28.48%	18,724,537.69

16.5 We have noted that the non-attainment of the estimated annual fund requirements in Section 2, Schedule 1 of the Loan Agreement was due lack of effective marketing and promotion strategies and lack of monitoring and technical assistance to the beneficiaries.

Marketing and Promotion Strategies

16.6 Year-end verifications conducted by the COA Auditors in the regions revealed that out of ten LCs, seven did not conduct marketing and promotion of the program and almost all LCs informed that target amount of ACSP fund for relending was not allocated to the concerned LCs/LUs, as shown in Annex 3. Thus, various cooperatives in the rural areas needing the financial assistance to improve their agricultural productivity were not given the chance to take part in the program.

Project Monitoring and Technical Assistance

16.7 E.O No. 30, Series of 2012, states that: "PMD I shall monitor the accounts that are tagged as funded under the ACSP through data to be generated from the SYMBOLS Loan System. The data shall be provided by the Banking Operations Group (BOG) through the SYMBOLS Project Team."

16.8 Section H.2 of the ACSP Guidelines provides that PMD I shall act as the overall project manager of ACSP, which shall supervise the day to day operation of the project (i.e. project assessment, monitoring of fund, drawdowns, conduct of technical assistance) and coordinate with other units of the bank and JICA on various activities to be undertaken relative to the implementation of the project.

16.9 Review showed, however that monitoring of the projects, as well as providing technical and capacity-building assistance to ACSP implementers and borrowers were not fully performed. Among the internal control procedures stated in the guidelines is that "PMD I shall ensure that loan accounts of borrowers are properly tagged/labeled in the database provided by BOG upon receipt of fund from JICA."

16.10 Proper tagging of the accounts is necessary in order to track which accounts are covered by the ACSP in a proper and organized manner. It is essential that loan accounts are correctly recorded and classified in the proper program for accurate and reliable financial reports. Also, monitoring of the loan accounts and the disbursements can aid the management in determining the percentage of utilization, upon assessing that the latter was not in harmony with the projected disbursement as stated in the loan agreement, it could be a signal to the concerned department to implement other courses of action or steps in improving the loan utilization through marketing and promotion to disburse the program fund.

16.11 In addition, year-end verifications conducted by the COA Auditors in the regions disclosed the following, as shown in Annex 3.

a. Out of the ten LCs inspected only five conducted field validation of the sub-projects, four of which were not with Program Management Department (PMD) I. Zamboanga LC conducts validation with Department of Agriculture while Bukidnon, Davao and Palawan LCs conduct field validation on their own. Evaluation also disclosed that not all LCs/LUs conducted the field validation with PMD 1 and even if they conducted the same, no data/information with regard assessment of the Project's progress was reflected in the Call Reports on file. Thus, it could be concluded that periodic progress and performance of the projects were not closely monitored or properly evaluated to assess the extent of attainment of the program's objectives.

b. Out of 23 borrowers interviewed, only four, namely Agrarian Reform Cooperative of New Guia and President Roxas Agrarian Reform Cooperative from Capiz LC, Cattubo Multi-Purpose Cooperative from La Union LC, and Spouses Dolores and Luis Espina from Batangas LC were extended Technical Assistance.

16.12 The results of the evaluation made as discussed above, clearly showed that the ACSP Guidelines were not fully implemented.

16.13 **We recommended that in future development programs, Management:**

a. Revisit marketing strategies to ensure that LCs/LUs and other concerned units of the Bank will be able to widely promote/advertise the program to the target market, thus, relend the fund within the period set in the agreement and minimize the payment of commitment fees for unutilized funds;

b. Ensure compliance with the implementing guidelines of development assistance loan programs, particularly with regard the monitoring and reporting of the status of projects funded by the loans to be able to provide reliable and accurate information/report to oversight

agencies, for the assessment of overall performance of the development programs of the government; and

c. Make sure that the LCs/LUs continue to conduct field validation as provided in Item 5, Chapter 10 of the Manual of Operations for Provincial Lending Centers on loan/project monitoring and include the actual status of the client/projects in the call reports to assess the attainment of the Program's objectives.

16.14 Management agreed and informed that several measures are presently being undertaken in subsequent development programs in order to improve fund utilization and implementation.

Easy Home Lending (EHL) Program

17. The documentary requirements and other procedural pre-requisites of the Easy Home Loan (EHL) accounts aggregating to P162.089 million were not complied with as provided in the LBP Credit Manual and provisions of the New Civil Code of the Philippines; thus exposing the bank to potential losses.

17.1 The LBP Credit Manual, Chapter VI, paragraph A.1 states that Loan Release or availment shall be in accordance with the approved terms and conditions and subject to completion of all necessary and appropriate legal documents as evidenced by a legal sufficiency memorandum prepared by the Banking Legal Services Department (BLSD), LBP.

17.2 One of the pre-release requirements for the purchase of completed and on-going construction of housing unit is the duly executed Deed of Undertaking (DOU) by the developer with borrower's conformity. Pertinent provisions of the DOU follow:

1. UNDERTAKINGS OF DEVELOPER/SELLER

a. Within a non-extendible period of three hundred sixty (360) days from Loan Release to the Developer/Seller, (the "Undertaking Period"):

(i) Cause the registration of the Deed of Absolute Sale with the proper Registry of Deeds, including the issuance of the Condominium Certificate of Title/s (CCT/s) or Transfer Certificate of Title/s (TCT/s).………,Tax Declaration/s, Real Estate Tax Receipt for the current year and Tax Clearance, **all in the name of the PURCHASER/BORROWER, ……**

(ii) Cause the transfer of the original owners duplicate of the ……TCT/s …. and the corresponding Tax Declaration/s Real Estate Tax Receipt and Tax Clearance for the current year, **all in the name of the PURCHASER/BORROWER and the registration and annotation of BANK's mortgage on the new TCT**…It is hereby understood that the presentation of the TCT ….to the proper Registry of Deeds for the transfer of title from the name of the DEVELOPER/SELLER to the

PURCHASER/BORROWER and the registration and annotation of BANK'S mortgage shall be handled by the representative of LANDBANK to be accompanied by the representative/s of the DEVELOPER/SELLER.

It is understood that the DEVELOPER/SELLER shall not delay, defer or prevent the transfer of the TCT/CCT and the corresponding Tax Declaration/s, Real Estate Tax Receipt for the current year and Tax Clearance in the name of the PURCHASER/BORROWER by the reason of the non-payment by the latter of any charges due to the former.

2. EVENTS OF DEFAULT

(a) If the DEVELOPER/SELLER is not able to deliver within the Undertaking Period, the Condominium/Transfer Certificate of Title, and/or Tax Declaration and/or other documents specified in Section 1(a) (ii) hereof, covering the Property, registered in the name of the PURCHASER/BORROWER and free from all liens and encumbrances……

xxx

(d) If the Purchaser/Borrower defaults on his/her obligation to pay amortizations for three (3) consecutive amortization payments

xxx

3. REMEDIES FOR DEFAULT

(a) Require the DEVELOPER/SELLER to repurchase the relevant Purchaser's account by paying to the BANK the outstanding principal balance of the loan plus the following accrued interest and penalty fees from the time the amount fell due until the same is fully paid.

xxx

(b) Declare the loan of the DEVELOPER/SELLER under its CTS Financing Facility and/or any other existing loan with the BANK immediately due and demandable without demand, presentment, protest, or notice of any kind, all of which are hereby waived by the DEVELOPER/SELLER and BANK, xxx"

7. REPRESENTATION AND WARRANTIES

The DEVELOPER/SELLER hereby represents and warrants to the BANK as follows:

(a) It has the full legal right and capacity to execute, deliver, and perform this Undertaking xxx…

xxx

(f) The DEVELOPER/SELLER has disclosed and shall promptly disclose to the BANK all facts and circumstances which may adversely affect or otherwise impair the validity and enforceability of this Undertaking xxx. ”

17.3 Pertinent provisions of the LBP Credit Manual provide the following:

Item 7, b), Chapter VIII

“b) The following are considered as past due accounts:

a. Loans or receivables payable on demand – if not paid on the date indicated on the demand letter, or within three (3) months from date of grant, whichever comes earlier;

Item B, b), i, Chapter V

REM as a contract by which a client or third party mortgagor secures in favor of the Bank the fulfilment of principal obligation subjecting as security immovable (real) properties or real rights over them in the event the principal obligation is not fulfilled at the time stipulated.

Annex V.1, Item IV

In case borrowers are not the owners of the property to be mortgaged, to check acceptability of the use of the Special Power of Attorney (SPA).

Annex V.1, Item III

Notarization properly done (signature of NP, printed name of NP, notarial seal on all pages of instruments, indication of the commission of the NP;

Notarial docket data properly and clearly filled up (Doc. No., page no., book no., year series)

Chapter V.A, Item 1

Contracts and documents implementing the loan/line shall be signed by the Head of the Lending Unit (LU) and the borrower or the borrower’s authorized signatory, and shall be reviewed for legal sufficiency.”

17.4 Further, pertinent provisions of the New Civil Code of the Philippines provide the following:

(a) “Article 2085. The following requisites are essential to the contracts of pledge and mortgage:

(1) xxx

(2) That the **pledgor or mortgagor be the absolute owner of the thing pledged or mortgaged;**

(3) That **the persons constituting the pledge or mortgage have the free disposal of their property,** and in the absence thereof, that they be **legally authorized for the purpose.**

Third persons who are not parties to the principal obligation may secure the latter by pledging or mortgaging their own property. (1857) (bold for emphasis)

(b) Article 2125.

In addition to the requisites stated in Article 2085, it is indispensable, in order that a mortgage may be validly constituted, that the document in which it appears be recorded in the Registry of Property. If the instrument is not recorded, the mortgage is nevertheless binding between the parties.

The persons in whose favor the law establishes a mortgage have no other right than to demand the execution and the recording of the document in which the mortgage is formalized. (1875a)"

17.5 Records show that the EHL loan balance amounted to P2,352,073,885.89 as of December 31, 2016 representing the accounts of 1,491 borrowers. To determine the propriety and validity of these accounts employing sampling methodology, the accounts of 88 EHL borrowers with past due loan balance amounting to P162,088,831.92 or seven per cent of the total EHL loan were selected as samples.

17.6 Examination of the Real Estate Mortgage (REM) Contracts of the 88 past due accounts amounting to P162,088,831.92 revealed the following deficiencies:

a. <u>EHL not supported with properties properly covered with TCTs or CCTs</u>

Examination disclosed that there are 37 EHL borrowers with undelivered CCTs/TCTs amounting to P65,032,709.40 or 42 per cent of 88 borrowers with past due loan balance amounting to P162,088,831.92. The Bank could not foreclose the property because the CCTs/TCTs have not been registered in the names of the purchasers/borrowers and delivered to the Bank by the developer/seller and the undertaking period of 360 days for the delivery of CCTs/TCTs have already elapsed.

The TCTs or CCTs attached to the REM indicate the names of the developers or real estate companies. The TCTs or CCTs listed in the "List of Properties Mortgaged" portion of the REM contracts were registered in the names of the developers or real estate companies.

b. EHL not supported with SPAs authorizing the borrowers to mortgage the property

In the EHL transactions, the borrowers are not the absolute owners of the property mortgaged and that they have no free disposal thereof, however, the REM was not supported with SPAs. Review of the loan files showed that SPAs are not among the documentations of the 37 EHL, which is not consistent with Article 2085 of the New Civil Code of the Philippines. Likewise, the absence of the SPAs is a violation of Item IV of Annex V.1 of the LBP Credit Manual. As a consequence, filing of foreclosure proceedings against the property mortgaged by the 37 borrowers cannot be instituted.

c. REM contracts not duly notarized and not registered in the Registry of Property

The REM contracts executed by 64 out of the 88 EHL borrowers, with loan balances aggregating P109,050,827.81 or 73 per cent of the samples selected with loan past due account balances of P162,088,831.92, were not notarized by a Notary Public and not registered in the Registry of Property contrary to Annex V.1, Item III of the LBP Credit Manual and Article 2125 of the New Civil Code of the Philippines. This is disadvantageous to the Bank, since the REM contracts were not reduced into a public document or formal writing.

The REM contracts are valid only between parties. In this regard, the remedies available for the default of payment of the loan, enumerated in paragraph 5 (Events of Default; Effects) of the REM contracts entered into by and between the EHL mortgagors/borrowers and the mortgagee/LBP, could not be imposed/applied because the REM contracts are not notarized and the property mortgaged are not titled in the name of the borrowers. This is greatly prejudicial to the interest of the Bank.

d. REM contracts not signed by the Mortgage Department Heads concerned

Five REM contracts executed by borrowers with loan balance amounting to P5,695,850.92 or six per cent of the 88 samples were not signed by the Head of the Mortgage Banking Department, contrary to Chapter V.A.1 of the LBP Credit Manual.

17.7 **We recommended that Management:**

a. Conduct examination on the availment of EHL loans with the end view of protecting the interest of the Bank, and most especially that of the borrowers by looking into the reasons why the TCTs/CCTs have not yet been turned over to the bank despite the lapse of the 360 days from Loan Release to the Developer/Seller;

b. Direct the Mortgage Department Heads to examine the REM contracts and accordingly affix their respective signature therein; and

c. Coordinate with the developers/sellers to immediately cause the transfer of the title of the property to the purchasers/borrowers within the Undertaking Period of 360 days. In addition, study the possibility of making the real estate developer/owner a party to the EHL contract.

17.8 Management informed that the Mortgage Banking Department (MBD) I and II consistently and continuously monitor compliance/submission of the post-release requirements from the developers, including TCTs/CCTs under the borrower's name. Moreover, the Bank offers the Tie-up facility between the Bank, Developers and Purchasers/Borrowers to fulfill its mandate to provide financial assistance to Filipinos to own affordable dwelling units. Management also mentioned that in order to effect the COA's recommendations, MBD I and II shall implement additional plan of action to implement the above audit recommendations.

Conditional Cash Transfer (CCT) Program

18. The LBP has no automated monitoring system linked to the other systems of the Bank, for the Funding, liquidation and related Service Fee (SF) of cash grants distribution through CCT Conduits despite being the depository and disbursing bank of the CCT Program for more than five years. Thus, monitoring of said transactions was prepared manually which entails tedious processes that are prone to human error.

18.1 For more than five years since the implementation of the CCT Program in July 14, 2011, the Bank had been persistent in fulfilling their commitment to support the said program by:

a. Tapping their LBP Cash Cards (LCC) in the distribution of CCT cash grants with 1,634 available LBP Automated Teller Machines (ATMs) as of December 2016. They even contracted Rural Bank of Kiamba to maintain the bank's ATM units located in some of the municipality in Sarangani province thru cash loading, replenishment and the daily reading to service the CCT beneficiaries.

b. Entering into separate agreements with 54 Accredited CCT Conduits including Rural Banks as of year 2016, from 51 conduits in year 2014. One of its Conduits, the First Consolidated Bank (FCB) has even issued their own PITAKARDS along with their Over-the Counter (OTC) payment.

18.2 Review of various CCT program documents/reports disclosed that all pay-out funds representing cash grants to CCT beneficiaries pass through the Bank Current Account Savings Account (CASA) system, while the LCC transactions of CCT beneficiaries was regularly recorded and monitored through the bank OCM 24 system. Also, Service Fee (SF) and Inter-bank withdrawal Fees can be generated or computed through the use of extracted data from the said database.

18.3 However, the distribution of cash grants through other CCT Conduits contracted by the Bank entails manual monitoring process because even if the pay-outs pass through the Bank CASA system, only the Conduits' deposit liability account balances as of a given date were available at the LBP servicing branches records. But, the said

Conduits' accounts balance sometimes includes personal funds, in cases when distribution of CCT cash grants were paid in advance by them.

18.4 The Bank have no existing system linked to its CASA and other systems for automated monitoring of the CCT Funding up to the Liquidation of CCT program funds entrusted to each of the Conduits, as well as monitoring of the related SF. Thus, monitoring of the same were done manually through encoding all the data/information submitted by the concerned Bank departments and servicing branches using Microsoft excel application, which were tedious and prone to human error.

18.5 Since the Conduits SFs were not the account of LBP servicing branches, the same were not recorded in the book and therefore no GL account were being maintained, instead reports are submitted to CCT-PMO for the preparation of Monitoring Report (MR). Thus, absence of the said Control account even made it more difficult to determine the completeness and accuracy of the data indicated in the said MR.

18.6 Interview with concerned personnel also disclosed that there were times when reports from concerned LBP Servicing Branches were not immediately submitted, that resulted in incomplete data of the Funding and Liquidation MR. As control measures, CCT-PMO conducts reconciliation of the Funding and Liquidation MR balance, simultaneously with the Service Fee MR balance as against the balance recorded in the concerned Conduit's book to establish the accuracy of the MR balance. However, the monitoring and reconciliation process with the data of all the 54 Conduits requires some time, due to volume of transactions with limited workforce.

18.7 In addition, if automated monitoring system is in place, the number of hours spent by concerned unit in the monitoring and reconciliation process would be lessened, in effect the amount charged to the CCT program for Manpower and other operating expenses incurred by the Bank would also be reduced.

18.8 Under the present administration, the CCT Program was expanded to include rice subsidy through cash grants worth P600 per month on top of the cash benefits allotment to beneficiaries, in which pay-out had already started in March of 2017 for the month of January of 2017, and more volume of CCT transactions were perceived. Thus, an automated monitoring system of the CCT Program Fund would be a useful tool for complete and accurate monitoring at reduced cost, and for transparency of public funds.

18.9 Also, inasmuch as the LCC existing OCM 24 system is currently being upgraded/enhanced to cover its transactions, the Bank ATM's increasing number, and to align with the National Retail Payment System (NRPS) positioned to facilitate the Philippines' transition from a cash-heavy to a cash-lite economy, the distribution of cash grants thru LCC rather than thru Conduits would be more beneficial to the Bank in terms of efficient monitoring of the CCT program, easy access of the fund to the beneficiaries and lesser SF chargeable to the said program.

18.10 **We recommended that Management consider:**

a. Developing an automated monitoring system for the CCT Program Fund and the CCT Conduits service fees receivable from DSWD, that is extracted or linked to the Bank CASA system to generate accurate and complete report as at a given date or period;

b. For the meantime, to continue maintaining proper documentation and monitoring of the CCT Program fund and Conduit's Service Fee Receivable from DSWD, using the data submitted/gathered from LBP EBSU, LBP Batasan Branch, the Conduits' designated LBP Servicing Branches and DSWD communications for the information as to payout extension; and

c. Distributing cash grants thru LCC except in remote places with no access to ATMs.

18.11 Management informed that a Technical Working Group (TWG) was created to handle the development of an automated system for CCT Program Fund and service fees receivable from DSWD. Further, the TWG shall also revisit the Conditional Cash Transfer Program System (CCTPS) developed by the Bank in 2012 for enhancement.

Rental of Branch Offices

19. The Tabuk and Sanchez Mira branches incurred rental expenses of P14.658 million from July 2002 to December 2016, due to the leasing of private buildings for the bank spaces, instead of constructing.

19.1 The Tabuk and Sanchez Mira branches started operations in 1994. Since the start of operations, they have been leasing its premises and structures for the branches and incurred rental expenses amounting to P14,657,880.00 as of December 31, 2016.

19.2 The Audit Team had prepared a Cost Benefit Analysis on the Purchase of a Commercial Building and Lot which was provided by the Property Valuation and Credit Information Department versus the payment of Leases basing from the current Lease Contracts of the two Branches available in records from 2002 to 2016, as shown below:

Branches	Contract Duration	Lessor	Lease Paid From January 2002 To December 2016	Res'l/ Comml Lot	Improvements (LBP Estimated Cost Ranges)	Savings
Sanchez Mira	01/1/02 to 12/31/16	Arturo Obispo, Sr.	P 9,030,000.00	867,500.00	P 4,164,000.00	P 3,998,500.00
Tabuk	July 2004 to December 30, 2016	Omengan Construction And Development Corporation	5,627,880.00	420,000.00	2,520,000.00	2,687,880.00
			P14,657,880.00	**P1,287,500.00**	**P 6,684,000.00**	**P 6,686,380.00**

19.3 It can be gleaned from the comparative cost-benefit analysis that even without including the cost of lease paid from 1994 to 2001, the bank could still have saved P6,686,380 in constructing their own building compared to rental payments on leased properties.

19.4 **We recommended that Management consider conducting a feasibility study in constructing its own branch buildings, rather than to continue incurring rental expenses.**

19.5 Management informed during the exit conference with the Sector on June 2, 2017, that the Management Committee of the Bank had already issued a resolution on Permanent Sites for Branches, and it was disseminated to all Branches Group Heads dated November 22, 2016 to purchase a lot or lot with building for new branches, relocation of branches and those branches with expiring contracts/too expensive contracts. Moreover, a board resolution dated May 30, 2017 was issued to Branch Banking Sector to scout for suitable properties for the branches.

C. Compliance with Regulations

Changes/modifications on the Motor Vehicle Lease Plan (MVLP)

20. The enhancements under LBP EO No. 050, series of 2012, as amended by LBP EO No. 056, series of 2014, providing the increase ranging from 92 to 133 per cent of the maximum entitlement of Bank officers and members of the BOD, and the granting of MVLPP to officers with Pay Grades 9 and 10 were inconsistent with the conditions approved by the Office of the President of the Philippines (OPP) in 1992.

20.1 The loan portfolio of LBP included Auto Loan Receivable account amounting to P229,248,010.11 as of December 31, 2016. This pertain to the unpaid amount of the purchase costs of vehicles granted under the MVLPP or Lease Purchase Car Plan to the officers and members of the BOD pursuant to LBP EO No. 16 series of 1992, which was amended by LBP EO No. 050 series of 2012, bearing on the subject Revised Guidelines on the Motor Vehicle Lease Purchase Plan for LANDBANK Directors and Officers, approved on April 10, 2012 under LBP Board Resolution No. 12-229, and was further amended by LBP EO No. 056, series of 2014. In CY 2016, a total amount of P63,748,467.99 was granted to one alternate member of the Board and 66 bank officers.

20.2 Under the LBP Guidelines, the MVLPP is a lease purchase undertaking that involves the acquisition of brand new motor vehicles which are leased to qualified Bank directors/officers with an option to purchase at any time during the lease period. The purchase price shall be the acquisition cost and other obligations due relating to the vehicle minus rentals paid. The director/officer is bound to purchase the leased vehicle at the end of the lease purchase contract

20.3 The granting of the MVLPP was originally based on the approval of the OPP in its letter dated May 4, 1992, which required, among others, compliance with the following conditions:

> "IV. Car Plan
>
> "1. That the Car Plan shall be limited to top officials/positions in the GFIs but not lower than the Director level position;"
>
> xxx
>
> "7. That any change in the terms and conditions of the Car Plan shall be subject to prior approval from the Office of the President."

20.4 As approved by the OPP, the persons eligible for the Car Plan under Section 3 of the Rules and Regulations for the Implementation of the Motor Vehicle Lease-Purchase Plan for GFI Officials are: (a) Members of the GFI Governing Board, and (b) Any officer based in the Philippines and holding a permanent appointment to his position irrespective of years in service in the GFI. Provided that, he does not have any pending administrative case, nor is he serving any penalty for an administrative case.

20.5 Section 4 of the same Rules and Regulations provides the maximum entitlement of the officers under the Car Plan, as follows:

> "The maximum entitlement of officers under the Plan shall be the cost of the motor vehicle model/brand, inclusive of the standard accessories already installed ex-plant, indicated opposite their respective position titles or their equivalent:

Position Titles	Vehicle Model/Brand
Members of the GFI Governing Board Chief Executive Officer or equivalent	Mitsubishi Galant Super Saloon
Second ranking officer or equivalent Third ranking officer or equivalent	Nissan Bluebird SGX-2 Toyota Corona Mitsubishi Spacewagon
For GFI Officers with Salary Grades 27-28	Toyota Lite Ace Toyota Corolla 1.6 Mitsubishi Lancer 1.5 SLX Mitsubishi L300 Van Nissan California 1.5 Nissan Sentra Diesel 1.7DX Nissan Sentra 1.6 SGX
For GFI Officers with Salary Grades 25-26	Mitsubishi Lancer 1.3 GL/EL Nissan Sentra 1.4SLX Toyota Corolla 1.3 Kia Pride Honda Civic Charade Fiat Uno

20.6 In line with this, the LBP, in LBP EO No. 16, series of 1992, established the maximum amount of entitlement of the eligible Bank officers/directors. In 2012, pursuant to LBP Board Resolution No. 12-229 dated April 10, 2012 which was implemented under LBP EO No. 050, series of 2012, the rates were increased ranging from 92 to 133 per cent, as shown in the following matrix:

Positions	LBP Rates approved in 1996	Current Rates per LBP EO No. 050, series of 2012	Amount of Increase	Percentage of Increase
Directors and President/CEO	P900,000	P2,000,000	P1,100,000	122
EVP (PG 17)	900,000	2,000,000	1,100,000	122
SVP (PG 16)	900,000	1,800,000	900,000	100
FVP (PG 15)	600,000	1,400,000	800,000	133
VP (PG 14)	600,000	1,200,000	600,000	100
AVP (PG 13)	500,000	1,000,000	500,000	100
DM or equivalent (PG 12)	500,000	960,000	460,000	92
ADM or equivalent (PG 11)	500,000	960,000	460,000	92

20.7 Further, in 2014, in accordance with LBP EO No. 056, series of 2014, Bank officers with Pay Grades 9 and 10 were allowed to avail the MVLPP.

20.8 The modification of the maximum entitlements and rates, and the inclusion of Bank officers with Pay Grades 9 and 10 to avail the MVLPP were made without the requisite approval from the Office of the President of the Philippines.

20.9 Moreover, some officers who previously availed of their maximum entitlement under LBP EO No. 16 series of 1992 were allowed to change and avail of their corresponding maximum entitlement under the amendatory LBP EO No. 050, series of 2012, and were authorized to transfer to LBP their unpaid loan balance from the Provident Fund Office (PFO).

20.10 As a result of increasing the maximum amounts of entitlement, in 2016 the total amount of availments was P57,340,052.92 or an increase of P26,740,052.92 or 46 per cent of the rates authorized under LBP EO No. 16 series of 1992. In addition, the total amount of availments of the officers with Pay Grades 9 and 10 was P6,408,415.07.

20.11 Thus, the transactions in regard to the modification of the maximum entitlements of the officers/directors and allowing officers with Pay Grades 9 and 10 to avail the MVLPP without the approval of the OPP, and allowing some officers to avail their corresponding increased maximum entitlement and authorizing them to transfer their unpaid balances from PFO to LBP were considered unauthorized.

20.12 **We recommended that Management:**

a. Seek approval from the Office of the President of the Philippines for the grant of the increased maximum amounts of entitlement of MVLPP to LBP officers/directors and the inclusion of Bank officers with Pay Grades 9 and 10 in the coverage of the LBP MVLPP, and

b. In the meantime, limit the granting of the said benefit to what was provided in the Guidelines approved by the Office of the President of the Philippines.

20.13 Management explained that:

a. The requirement under Item IV.7 of OPP letter dated May 4, 1992 was already superseded by the OPP letter/approval-letter dated July 20, 1992 that made reference to the Implementing Guidelines. It was emphasized that the said approval did not contain any provision requiring the prior approval from the OPP for any change in the terms and conditions of the Car Plan;

b. The Bangko Sentral ng Pilipinas (BSP) was given delegated authority by the OPP to approve any revision to the implementing rules and regulations of the MVLPP. The BSP over the years exercised the authority given to it by the OPP as regards the car plans of GFIs and any amendments thereto without need of prior approval from the OPP. The approving authority of BSP was further emphasized when the same was eventually enshrined in the Manual of Regulation for Banks (MORB) which LANDBANK respected and faithfully adhered to when it comes to its MVLPP amendments; and

c. BSP very well knew the extent of its authority when the approval of the LANDBANK's amendments to its MVLPP was made subject only to the: (1) Bank's continuing compliance with applicable provisions of Section X338 and Subsection X339.4 of the MORB on Financial Assistance to Officers and Employees and Reportorial Requirements, respectively; and (2) Bank's compliance with relevant provisions under RA No. 10149 (the GOCC Governance Act of 2011).

20.14 As a rejoinder, we maintain our recommendations since item IV.7 of the OPP letter dated May 4, 1992 approving the Rules and Regulations for the Implementation of MVLPP explicitly provided that *any change in the terms and conditions of the Car Plan shall be subject to prior approval from the Office of the President*.

Payment of uniform allowance to LBP officers and employees

21. The transfer of funds in the aggregate amount of P76.505 million for the CYs 2016 and 2017 uniform allowance of middle management officers and rank-and-file employees to the LBP Middle Management Officers Association, Inc. (LBPMMOAI) and LBP Employees Association (LBPEA) is not in accordance with the handling and safekeeping of public funds.

21.1 LBP Special Order (SO) No. 421, series of 2004, dated June 22, 2004, recognized the LBPMMOAI and LBPEA as agents/representatives of the employees so as to administer the funds for uniform allowance granted by the Bank to the employees. As such, they were obliged to undertake the following functions: (a) assist the employees in the inspection/acceptance of the uniform sets delivered by the couturiers/suppliers, and in a random inspection/checking of uniforms for field personnel prior to shipment; (b) remit payment to employees who may be entitled to the uniform allowance encashment; (c) prepare a schedule of late deliveries and compute the penalty and other charges for collection from the couturiers/suppliers copy furnished the Accounting Department; (d) validate the actual number of uniform sets delivered to and accepted by the employees against the couturiers/suppliers' billing; (e) pay the couturiers/suppliers based on the contract/billing statement; and (f) prepare and submit to the Personnel and Accounting Departments a quarterly accounting of the funds released to their accounts and the disbursements from the same.

21.2 In the same SO, the Accounting Department was authorized to coordinate with the Employees Uniform Committee, LBPMMOAI and LBPEA for the release of the funds.

21.3 Pursuant to the SO, in 2016, the amounts of P10,200,000.00 and P66,305,000.00 were released to LBPMMOAI and LBPEA, respectively, for the uniform allowance for CYs 2016 and 2017 of the middle management officers and rank-and-file employees, covered by the following reference documents and details:

Disbursement Order			Official Receipt			
Number	Date	Payee	Number	Date	Particulars	Amount
CY 2016						
295488	04/28/2016	LBPMMOAI	1151	05/25/2016	610 Female officers (Bankwide) – cost of fabric	P 963,800.00
296754	05/10/2016	LBPMMOAI	1158	06/16/2016	444 Male officers (Bankwide) – cost of fabric	976,800.00
298959	05/16/2016	LBPMMOAI	1202	06/28/2016	610 Female officers and 444 Male officers (Bankwide) – cash portion	2,086,200.00 1,243,200.00
291830	03/21/2016	LBPEA	0130	04/01/2016	1,567 Female rank-and-file employees (HO and NCR)	7,835,000.00
291831	03/21/2016	LBPEA	0128	04/01/2016	2,846 Female rank-and-file employees (Provincial)	14,230,000.00
291832	03/21/2016	LBPEA	0129	04/01/2016	2,181 Male rank-and-file employees (Bankwide)	10,905,000.00
						P38,240,000.00
CY 2017						
314317	11/14/2016	LBPMMOAI	1210	11/23/2016	410 Male officers	P2,050,000.00
313850	11/11/2016	LBPMMOAI	1211	11/23/2016	576 Female officers	2,880,000.00
312186	10/24/2016	LBPEA	0202	11/09/2016	1,526 Female rank-and-file employees (HO and NCR)	7,630,000.00
309468	9/23/2016	LBPEA	0176	10/11/2016	2,183 Male rank-and-file employees (Bankwide)	10,915,000.00
309469	9/23/2016	LBPEA	0175	10/11/2016	2,958 Female rank-and-file employees (Provincial)	14,790,000.00
						P38,265,000.00
Total						**P76,505,000.00**

21.4 The LBPMMOAI and LBPEA are recognized by the Bank as agents/representatives of the employees and were required to prepare and submit to the Personnel and Accounting Departments a quarterly accounting of the funds released to their accounts and the disbursements from the same and furnish the Accounting Department of a copy of the schedule of late deliveries and computation of the penalty and other charges for collection from the couturiers/suppliers. However, the practice of channelling the funds to these associations and allowing them to administer the government funds by paying the selected couturiers/suppliers and employees who are entitled to the uniform allowance encashment, is not proper

21.5 The foregoing transactions are not in line with the declared policy of the State provided under Section 2 of Presidential Decree No. 1445, that *all resources of the government shall be managed, expended or utilized in accordance with law and regulations, and safeguarded against loss or wastage through illegal or improper disposition, with a view to ensuring efficiency, economy, and effectiveness in the operations of government*. These violate the principle on accountability and safekeeping of public funds. It is a cardinal rule that management of public funds shall be under the possession, custody and control of the government through its authorized accountable public officers. It is not permitted that the public funds be transferred and managed by a private individual/entity as the risk of financial loss due to mismanagement, misuse or improper disposition is high.

21.6 **We recommended that Management discontinue the practice of channelling the funds for the employees' uniform allowance to LBPMMOAI and LBPEA and allowing them to administer said funds.**

21.7 Management explained that the grant of uniform/clothing allowance to LBP employees is in the form of cash pursuant to Department of Budget and Management (DBM) Budget Circular No. 2012-01 dated February 23, 2012.

21.8 The uniform allowance was given to the employees as part of their compensation/benefits through their authorized representatives/agents, the LBPMMOAI and LBPEA. These associations were allowed to administer the said allowance, in behalf of the employees, to ensure consistency in the uniform design, color and material in keeping with appropriate corporate image. The employees, instead of individually procuring their uniforms, have done collectively and voluntarily through these associations. Hence, the funds transferred to these associations cannot be anymore considered as public funds.

21.9 In addition, Management committed to explore the possibility of incorporating a provision in the 2017 CNA with the LBPEA and similar documentation with the LBPMMOAI relative to the authority of the said associations to receive the funds for uniform allowance and to administer the same in behalf of the employees.

21.10 As a rejoinder, it cannot be said that the uniform/clothing allowance was given in cash since the employees received finished uniforms from LBPMMOAI and LBPEA and not received through a payroll or equivalent document.

21.11 The LBPMMOAI and LBPEA, were not authorized by the employees as their representatives/agents in the administration of the allowance. It was the LBP, through Special Order No. 421 series of 2004 that designated the said associations as the administrators of the allowance granted by the Bank to the employees.

LBP Guidelines on Liability Indemnity Fund (LIF)

22. The LBP's Guidelines on the creation of its Liability Indemnity Fund (LIF) was not submitted for GCG's approval pursuant to Governance Commission for GOCCs (GCG) Memorandum Circular No. 2012-10.

22.1 This is an update on the audit observation reported in 2015 Annual Audit Report.

22.2 As reported in CY2015 Annual Audit Report for LBP, a Liability Indemnity Fund (LIF) which is part of the Liability Indemnity Plan was established and created to cover the liability of Directors, Officers and Employees (DOEs) for loss or damage adjudged or awarded to the other party per judgment, judicial settlement or compromise which may arise from administrative, criminal, or civil suit filed against the Bank and/or against him in connection with the performance of his official function or on account of his official position pursuant to LBP Executive Order No. 50, Series of 2010. For monitoring purposes, a Miscellaneous Contingent Asset account is maintained in the books of accounts of LBP. The LIF is currently held in trust by the Trust Banking Group (TBG).

22.3 The previous year's recommendation to reclassify the annual contributions to LIF from Miscellaneous Expense to an asset account was not implemented. The annual contributions already accumulated to P35 million as of December 31, 2016. Based on the Statement of Financial Position of the Fund submitted by TBG, the total balance of the LIF was P38,851,365.08 as of December 31, 2016. This shows that the total amount contributed by LBP to the said fund from CY2011 to CY2016 was still intact and there was accumulated interest earned of P3,851,365.08 which was not also recognized and recorded as income in the LBP books of accounts.

22.4 In reply to our Audit Observation Memorandum, Management explained that the LIF was established as a "self-insurance scheme" whereby the annual contributions to build the fund are treated as expense. It is more feasible and efficient instead of securing insurance policy where premiums are treated as expense. The said scheme was recognized by GCG, in its Memorandum Circular 2012-10. The same GCG Circular states that *it is within the authority of the Governing Board of every GOCC to adopt a scheme which may be wholly Directors and Officers Liability Insurance (DOLI)-covered, or wholly Directors and Officers Liability Fund (DOLF)-covered, or a combination of both, in order to ensure the most optimum coverage for the GOCC, taking into consideration the corporate operating environment, as well as the GOCC's litigation history.*

22.5 However, paragraph V of the CGC Circular No. 2012-10 provides among others that:

> "V(5) Formal Guidelines shall be promulgated by the Governing Board of the GOCC defining the essential items for the DOLF, i.e., the cap on the fund, overseeing legal fund committee, evaluation of adequacy of fund, coverage, expenses covered, allowable indemnification amounts, procedure for availment booking of the advance, etc., <u>which must be submitted to the GCG for formal approval</u>."(Emphasis Ours)

22.6 Since the LBP's existing Guidelines for the creation of the fund was made in CY2010 which was earlier than the date of the CGC Circular No. 2012-10, the LBP's existing guidelines on the creation of the LIF is without the required approval from GCG.

22.7 **We recommended that Management submit the Guidelines on LIF to GCG for formal approval in compliance with GCG Memorandum Circular No. 2012 -10**.

22.8 Management informed that they will revisit the guidelines and evaluate the required submission to the GCG.

Performance/Accomplishments vs. Targets

23. In 2016, the Bank faced the challenges brought about by the ASEAN integration, internal and external structural, financial and regulatory reforms. The Bank continued to carry out its mandate through implementation of various programs, and had successfully accomplished the targeted outputs for the period as shown in Annex 4. The Bank also received the following awards in recognition of its outstanding performance in CY 2016:

	Awards	Description
1.	Customer Service Provider of the Year Asia 2016	For innovation and leadership in the field of banking customer service in Asia
2.	Best Agribusiness Bank/Best CSR Bank	For contribution to agricultural productivity, food, security.
3.	Asian Bank of the Year	For effort toward financial inclusion, and for supporting farmers MSMEs, and agri and aqua businesses.
4.	Most Socially Responsible Bank/ Most Innovative Lending Platform/ Best CSR Initiative	For promoting innovation and social awareness through its financial services, including one for digital banking facility – The LandBank Mobile Loan Saver (LMLS).
5.	Most Innovative Deal	For the role as joint lead arranger for the multi-billion peso Therma Visayan Loan Facility. The Bank was chosen by The Asset Magazine (Asia Infrastructure Awards 2016).
6.	Best SME Product in the Philippines	For the Bank's Bringing Urbanization and Innovations thru LandBank's Diverse Engineering Resource Support (BUILDERS) Program which was recognized by The Asian Banker in the Philippine Country Awards 2016. This affirmed the Bank's significant contribution in extending credit support to private and public sector players in the industry.
7.	Domestic Retail Bank of the Year	For local banking performance and the Management Leadership and Development Program of the Bank given by the Asian Banking and Finance Magazine.
8.	Certificate of Merit: Climate SMART Financing Program	The Bank was commended for its Climate SMART Program (Climate Synergistic Mitigation, Adaptation, Resiliency and Transformation) that focuses on various aspects towards mitigating climate change. The award was given under the Best Innovation in Sustainable Finance Products and Service category.
9.	Outstanding Development Project – Talayan Sewage Treatment Plant	For the assistance provided by the Bank for the Talayan Sewage Treatment Plant, a sustainable development project.
10.	Quest for Excellence Award	The Bank became the only Philippine Bank to receive this recognition and is one of only two banks awarded in 2016. This win makes, Land Bank the only bank in the 22 years of APQO award-giving to receive the third highest recognition under non-profit or government category.

Awards		Description
11.	Top Performing Government Securities Eligible Dealer (GSED	For the outstanding contribution in support of the local Government Securities market. For the third straight year, LANDBANK was named as the top performing Government Securities Eligible Dealer (GSED) at the annual recognition ceremony hosted by the Bureau of the Treasury (BTr).
12.	Top 5 Spot Foreign Exchange Dealer/ Top 5 Fixed Income Dealing participant	For placing 2nd in total foreign exchange transactions, and 5th in the total securities transactions, the Philippine Dealing System gave these two awards.
13.	Environmental Impact Award	For putting the spotlight on efforts toward curbing ecological destruction through various inter-agency initiatives, the Bank was recognized for its Manila Bay SUNSET Partnership Program.
14.	Philippine Quill Award of Merit – LandBank 2015 Calendar	For the calendar project of the Bank that featured various caves in the country and other intrinsic elements which was recognized under the Communication Skills category of the competition.
15.	Kampeon ng Katubigan	For the Bank's two CSR programs – the Manila Bay SUNSET Partnership Program and Adopt-A-Watershed Phase II – each received an award for promoting water and environmental sustainability.
16.	Proficiency in Quality Management (Level 2)	For validating efforts towards performance excellence through quality management practices, the Philippine Quality Award (PQA) was given for the Bank's significant progress in sound processes. This recognition resulted in the nomination by the Development Academy of the Philippines to the Global Performance Excellence Award.

Compliance with Republic Act No. 7656

Parent

24. The LBP Board of Directors in Board Resolution No. 17-015 dated January 10, 2017 approved the proposal to recommend LBP's Exemption from Dividend Payment to the National Government for its 2016 Net Income. In consideration of the current constraints on capital position of the Bank, the Department of Finance recommended for approval of the President of the Philippines a zero dividend rate on 2016 net income.

Subsidiaries

24.1 In compliance with Republic Act No. 7656, the following subsidiaries declared and remitted cash dividends totaling P130.568 million to the Bureau of the Treasury (BTr) for CY 2016:

Name of Subsidiaries	Amount (In million pesos)
LBP Leasing and Finance Corporation	48.751
LBP Insurance Brokerage, Inc.	37.759
LBP Resources and Development Corporation	30.498
Masaganang Sakahan, Inc.	13.560
	130.568

Gender and Development

25. For CY2016, the Parent engaged in various Gender and Development (GAD) activities such as the continuous operations of the LANDBANK Day Care Center and Lactation Station, responsible Parenthood Education Fora/Learning Sessions Implementation of Leave Privileges, joined in the 2016 National Women's Month (NWN) celebration and other activities that were aligned with the Annual Plans and Programs for CY2016. A total of P23,687,031.60 was disbursed for these activities as reported in LBP's Annual GAD Accomplishment for the year.

Compliance with Tax Laws

26. Taxes withheld for the month are remitted on or before the tenth day of the following month, except those withheld for the month of December which were remitted January 2017.

26.1 In compliance with Tax Laws, information on taxes and licenses paid or accrued during the taxable year 2016 were disclosed in Part I of this report, specifically under Notes to the Financial Statements. The taxes withheld from compensation, benefits and other sources amounting to P2.7 billion were remitted to the Bureau of Internal Revenue in accordance with the deadlines on payment/remittance of taxes prescribed by the National Internal Revenue Code.

Philhealth and Pag-ibig Premiums

27. In CY 2016, complied with Title III Rule III, Section 18 of the Implementing Rules and Regulations of Republic Act (R.A) No. 7875 as amended in the payment of national health insurance premium contributions to the Philhealth.

27.1 LBP also complied with Rule VII, Section 3 of the Implementing Rules and Regulations of R.A. No. 9679 in the collection and remittance of contributions to the Pag-ibig Fund.

GSIS Contributions and Remittances

28. In CY 2016, LBP complied with the rules and regulations implementing the GSIS Act of 1997, particularly on the collection and remittance of contributions to GSIS as follows:

a. Mandatory monthly contribution of covered employees and employer in accordance with Section 18, and

b. Remittance of employee's and employer's contributions and employee's compensation premium within the due date pursuant to Section 19.

Status of Audit Suspensions, Disallowances and Charges

29. The total audit suspensions and disallowances as at December 31, 2016 is P62,802,303.44, broken down as follows:

	Suspended	Disallowed	Total
Head Office	P 6,007,911.58	P 8,615,894.47	P14,623,806.05
Regional Offices/Branches	39,334,964.46	8,843,532.93	48,178,497.39
	P45,342,876.04	**P17,459,427.40**	**P62,802,303.44**

29.1 These suspensions and disallowances were mostly payments of benefits and allowances to LBP Board of Directors, officers and employees which were not in accordance with existing laws, rules and regulations. Management has already filed appeals on the Notices of Disallowances, in accordance with the Revised Rules and Procedures of the Commission on Audit (RRPC).

29.2 There are no audit charges as at December 31, 2016.