Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Ave., Quezon City

ANNUAL AUDIT REPORT

on the

SMALL BUSINESS CORPORATION
(Small Business Guarantee and Finance Corporation)

For the Year Ended December 31, 2014

REPUBLIC OF THE PHILIPPINES
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines

Corporate Government Sector
Cluster 2-Social Security Services and Housing

July 14, 2015

Mr. BENIGNO L. ZIALCITA III 7/14/15 11:29 AM
President and Chief Executive Officer
Small Business Corporation
139 Corporate Center Building
139 Valero St., Salcedo Village
Makati City

Dear Sir:

Pursuant to Section 2, Article IX-D of the Philippine Constitution and Section 43 of Presidential Decree No. 1445, otherwise known as the Government Auditing Code of the Philippines, we transmit herewith our report on the results of the audit of the accounts and transactions of **Small Business Corporation** for the year ended December 31, 2014.

The report consists of the Independent Auditor's Report, the Audited Financial Statements, the Observations and Recommendations, and the Status of Implementation of Prior Years' Audit Recommendations.

The Auditor expressed an unqualified opinion on the fairness of the presentation of the financial statements of the Corporation.

The significant observations and recommendations that need immediate actions are as follows:

1. Personnel services and employees benefits totaling to P30.778 million were not approved by the Office of the President (OP) and are in excess of the Department of Budget and Management (DBM) approved Corporate Operating Budget (COB), contrary to Section 10 of Republic Act (RA) No. 10149 and the pertinent provisions of Presidential Decree (PD) Nos. 1597 and 1445, thus, without legal basis.

1.1. We recommended that Management:

a. Seek OP approval, through the DBM, of the personnel services and employees benefits expenses as required under Section 10 of RA 10149 and pertinent provisions of PD Nos. 1597 and 1445;

b. Submit the latest status of the CPCS for approval of the President; and

c. Henceforth, suspend and/or discontinue the grant of the subject benefits.

2. Six acquired assets with total market value of P27.346 million are either occupied by informal settlers or previous owners, hampering immediate disposal and significantly reducing its value and marketability. Moreover, two items of chattels with total appraised value of P1.164 million are still in the possession of the previous owners, exposing them to risk of loss contrary to the SBC policies and guidelines on Management of Acquired Assets (AA) under SBC Board Resolution No. 466, series of 1998.

2.1 We recommended that Management:

a. Strictly adhere to SBC policies and guidelines on acquired assets.

b. Pursue aggressive legal action in asserting the rights of SBC over the acquired assets; and

c. Conduct regular monitoring of the conditions of acquired assets.

3. Five acquired assets with an aggregate book value of P8.526 million and total appraised value of P25.665 million were not disposed of within the prescribed period of five years, contrary to the provisions of the General Banking Act of 2000, depriving SBC the opportunity to generate necessary funds to sustain its operations.

3.1 We recommended that Management:

a. Comply strictly with the provisions of the General Banking Act of 2000 on the disposal of acquired assets within five years; and

b. Initiate immediate disposal of these acquired assets

4. The appraisal of five acquired assets with total last appraisal value of P21.572 million is not updated contrary to BSP Circular No. 520, series of 2006.

4.1 We recommended that Management comply strictly with the BSP guidelines on the appraisal of acquired assets.

5. BMBE Development Fund amounting to P413 million, held in trust by SBC, was not utilized for more than three years (CYs 2012 to 2014) defeating the purpose for which the Fund was created.

5.1 We reiterated our prior year's recommendation that Management, as part of the MSMED Council, to accelerate the utilization of the BMBE Fund to generate much needed employment and alleviate the informal sectors from poverty, otherwise, revert the Fund, now dormant, to the General Fund of the Government in accordance with Executive Order No. 431, series of 2005.

The other audit observations together with the recommended courses of action which where discussed by the Audit Team with concerned Management officials and staff during the exit conference conducted on June 18, 2015 are discussed in detail in Part II of the report.

We respectfully request that the recommendations contained in Part II of the report be implemented and that this Commission be informed of the actions taken thereon by accomplishing the Agency Action Plan and Status of Implementation Form (copy attached) and returning the same to us within 60 days from the date of receipt hereof.

We acknowledge the support and cooperation that the Management extended to the Audit Team, thus facilitating the completion of the report.

Very truly yours,

Commission on Audit

By:

MARY S. ADELINO
Director IV

Copy furnished:

The President of the Republic of the Philippines
The Vice President
The Speaker of the House of Representatives
The Chairperson – Senate Finance Committee
The Chairperson – Appropriations Committee
The Secretary of the Department of Budget and Management
The Governance Commission for Government-Owned and Controlled Corporations
The Presidential Management Staff, Office of the President
The UP Law Center
The National Library

REPUBLIC OF THE PHILIPPINES
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines

Corporate Government Sector
Cluster 2-Social Security Services and Housing

July 14, 2015

The Board of Directors
Small Business Corporation
139 Corporate Center Building
139 Valero St., Salcedo Village
Makati City

S B G F C
OFFICE OF THE CORPORATE SEC.
RECEIVED
BY : Jen
DATE : 07/16/2015
TIME : 11:41 AM

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The other audit observations together with the recommended courses of action which where discussed by the Audit Team with concerned Management officials and staff during the exit conference conducted on June 18, 2015 are discussed in detail in Part II of the report.

In a letter of even date, we respectfully requested the President and Chief Executive Officer, Small Business Corporation, that the recommendation contained in Part II of the report be implemented and that this Commission be informed of the actions taken thereon by accomplishing the Agency Action Plan and Status of Implementation Form (copy attached) and returning the same to us within 60 days from the date of receipt hereof.

We acknowledge the support and cooperation that the Management extended to the Audit Team, thus, facilitating the completion of the report.

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EXECUTIVE SUMMARY

INTRODUCTION

The Small Business Guarantee and Finance Corporation (SBGFC) is a government corporation created on January 24, 1991 by virtue of Section 11 of Republic Act (RA) No. 6977, as amended on May 6, 1997 by RA No. 8289, otherwise known as "Magna Carta for Small and Medium Enterprises. On May 23, 2008, the President of the Philippines signed into law RA No. 9501, titled "An Act to Promote Entrepreneurship by Strengthening Development and Assistance Programs to Micro, Small and Medium Scale Enterprises Amending for the Purpose Republic Act No. 6977, as amended, otherwise known as the "Magna Carta for Small and Medium Enterprises" and for other purposes. The law, among other items, increases the Corporation's authorized capital stock from P5 billion to P10 billion. Under Section 11 of RA No. 9501, the SBGFC is hereinafter referred to as the Small Business Corporation (SBC), which shall be charged with the primary responsibility of implementing comprehensive policies and programs to assist Micro, Small and Medium Enterprises (MSMEs) in all areas, including but not limited to finance and information services, training and marketing.

The SBC is under the policy program and administrative supervision of the Micro, Small and Medium Enterprises Development (MSMED) Council of the Department of Trade and Industry (DTI).

The Corporation's principal address is at the 17th and 18th floors, 139 Corporate Center, 139 Valero St., Salcedo Village, Makati City. It has four area offices, one unit office and 15 desk offices within the Philippines and has 137 regular and temporary employees for the calendar year 2014.

The policy making body of the Corporation is the Board of Directors composed of 10 members headed by a Chairman, who likewise performs the functions of the Chief Executive Officer. The President of SBC acts as the Chief Operating Officer.

The Corporate Operating Budget (COB) for Calendar Year 2014 of SBC, as approved by the Board of Directors, consists of the following:

Revenues	P385,300,000
Expenses	335,000,000
Net Operating Income	**P 50,300,000**
Capital Outlay	**P 20,000,000**

The Governance Commission for Government Owned and/or Controlled Corporations (GCG) recommended for the approval of the said COB with the Office of the President. The said COB was approved by the DBM except for Personal Services (PS) amounting to P41.616 million and Maintenance and other Operating Expenses (MOOE) amounting to P5.594 million for excess provisions and/or grant of allowances without the approval of the Office of the President of the Philippines.

FINANCIAL HIGHLIGHTS

1. Comparative Financial Position (In Philippine Peso)

Particulars	2014	2013	Increase (Decrease)
Assets	5,115,709,498	5,903,687,972	(787,978,474)
Liabilities	2,565,763,971	3,501,055,416	(935,291,445)
Equity	2,549,945,527	2,402,632,556	147,312,971

2. Comparative Results of Operations (In Philippine Peso)

Particulars	2014	2013	Increase (Decrease)
Income from operations (net of finance cost and allowance for loan impairment)	170,928,635	192,155,345	(21,233,710)
Other income	26,564,991	14,870,190	11,694,801
Total income	197,493,626	207,025,535	(9,531,909)
Personal services	108,206,169	114,962,005	(6,755,836)
Maintenance and other operating expenses	72,045,820	73,315,153	(1,269,333)
Other expenses	2,365,165	1,854,057	511,108
Total expenses	182,617,154	190,131,215	(7,514,061)
Net income before tax	14,876,472	16,894,320	(2,017,848)
Current	(3,632,353)	(3,477,314)	(155,039)
Deferred	20,982,540	7,784,456	13,198,084
Net income	32,226,659	21,201,462	11,025,197
Other comprehensive gain (loss)	115,086,312	(79,830,472)	194,916,784
Total comprehensive income (loss)	147,312,971	(58,629,010)	205,941,981

SCOPE OF AUDIT

Our audit covered the accounts and operations of the Small Business Corporation for the calendar year 2014. It aimed to ascertain the fairness of the presentation of the financial statements in accordance with the Philippine Financial Reporting Standards. Our audit was also made to assess the propriety of financial transactions and compliance with laws, rules and regulations.

AUDITOR'S OPINION

We rendered an unqualified opinion since all material adjustments arising from our audit recommendations on significant audit observations were taken up in the books.

However, attention was drawn to Note 9 to financial statements stating that the Corporation treated Foreign Exchange Risk Cover as a derivative financial instrument and consequently adopted the Black-Scholes Model to measure the value of the derivative call option, resulting in an increase of the Corporation's assets by P242.824 million in calendar year 2014. Our opinion is not modified in respect of this matter until Management has completed the review of the applicability of the Black-Scholes Model and its impact on the balance of the pertinent accounts presented in the financial statements.

OTHER SIGNIFICANT AUDIT OBSERVATIONS AND RECOMMENDATIONS

1. Personnel services and employees benefits expenses totaling to P30.778 million were not approved by the Office of the President (OP) and are in excess of the Department of Budget and Management (DBM) approved Corporate Operating Budget (COB), contrary to Section 10 of Republic Act (RA) No. 10149 and pertinent provisions of Presidential Decree (PD) Nos. 1597 and 1445, thus, without legal basis.

1.1 We recommended that Management:

a. Seek OP approval, through the DBM, of the personnel services and employees' benefits expenses as required under Section 10 of RA 10149 and pertinent provisions of PD Nos. 1597 and 1445.

b. Submit the latest status of the Compensation Position Classification System (CPCS) for approval of the President; and

c. Henceforth, suspend and/or discontinue the grant of the subject benefits.

2. Six accounts of acquired assets with total value of P27.346 million are either occupied by informal settlers or previous owners, hampering immediate disposal and significantly reducing the value and marketability. Moreover, two items of chattels with total appraised value of P1.164 million are still in the possession of the previous owners, exposing these to risk of loss contrary to the SBC policies and guidelines on Management of Acquired Assets (AA) under SBC Board Resolution No. 466, series of 1998.

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STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

Out of the 15 audit recommendations embodied in the prior years' Annual Audit Report, eight were fully implemented, four were partially implemented and three were not implemented.

TABLE OF CONTENTS

PART I

AUDITED FINANCIAL STATEMENTS

REPUBLIC OF THE PHILIPPINES
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City, Philippines

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Small Business Corporation
(Small Business Guarantee and Finance Corporation)
Makati City

We have audited the financial statements of Small Business Corporation, which comprise the statement of financial position as of December 31, 2014, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Unqualified Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Small Business Corporation as at December 31, 2014, and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

Emphasis of Matter

We draw attention to Note 9 to the financial statements wherein the Corporation treated Foreign Exchange Risk Cover as a derivative financial instrument and consequently adopted the Black-Scholes Model to measure the value of the derivative call option, resulting in an increase of the Corporation's assets by P242.824 million in calendar year 2014. Our opinion is not modified in respect of this matter until Management has completed the review of the applicability of the Black-Scholes Model and its impact of the balances of the pertinent accounts presented in the financial statements.

COMMISSION ON AUDIT

REBECCA A. DUMAGUIT
State Auditor V
Supervising Auditor

June 19, 2015

SMALL BUSINESS CORPORATION

DEPARTMENT OF TRADE & INDUSTRY PHILIPPINES

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Small Business Guarantee and Finance Corporation is responsible for all information and representations contained in the balance sheet as of December 31, 2014 and the statement of income, changes in equity and cash flow for the year then ended. These financial statements have been prepared in conformity with Philippine Financial Reporting Standards and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized

The Board of Directors reviews the financial statements before such statements are approved and submitted to the stockholders of the company

The Commission on Audit (COA), has audited the financial statements of the Company in accordance with auditing standards generally accepted in the Philippines and has expressed their opinion on the fairness of presentation upon completion of such audit, in their report to the stockholders and Board of Directors.

B. Zialcita III
BENIGNO L. ZIALCITA III
President / CEO

ALFREDO S. DIMACULANGAN
Head- Resource Management Sector

Date: July 8, 2015

RECEIVED - COA - SBGFC
DATE: 7-3-15/3:34

17th and 18th Floors, 139 Corporate Center, 139 Valero Street, Salcedo Village, Makati City, 1227 Makati City, Philippines
Telephone: (632) 751-1888 Fax: (632) 813-5727 / 894-1677 E-mail: sbcorporation@sbgfc.org.ph
Website: www.sbgfc.org.ph

SMALL BUSINESS CORPORATION
STATEMENT OF FINANCIAL POSITION
December 31, 2014
(In Philippine Peso)

	Notes	2014	2013
ASSETS			
Current Assets			
Cash and cash equivalents	5	**147,087,807**	507,012,483
Short-term held-to-maturity investments	6	**92,548,042**	236,904,028
Due from banks and other financing institutions - net, current portion	7	**1,651,841,067**	2,004,207,636
Loans and receivables - net, current portion	8	**523,146,569**	457,006,126
		2,414,623,485	3,205,130,273
Non-Current Assets			
Financial assets at fair value through profit or loss	9	**242,824,008**	298,138,952
Long-term held-to-maturity investments	6	**1,671,774,035**	1,565,443,703
Due from banks and other financing institutions - net of current portion	7	**64,459,454**	268,040,115
Loans and receivables - net of current portion	8	**361,747,159**	222,994,911
Investment in equity instrument - net	10	**15,091,575**	8,212,500
Investment property - net	11	**136,942,115**	144,593,140
Property and equipment - net	12	**79,611,769**	83,096,712
Other assets	13	**128,635,898**	108,037,666
		2,701,086,013	2,698,557,699
TOTAL ASSETS		**5,115,709,498**	5,903,687,972
LIABILITIES AND EQUITY			
Current Liabilities			
Notes payable – current portion	14	**1,143,848,948**	1,190,187,323
Long-term liabilities - current portion	15	**84,824,936**	97,024,528
Other current liabilities	16	**70,317,824**	85,613,393
		1,298,991,708	1,372,825,244
Non-Current Liabilities			
Notes payable – net of current portion	14	**31,546,378**	48,099,060
Long-term liabilities – net of current portion	15	**1,235,225,885**	2,080,131,112
		1,266,772,263	2,128,230,172
TOTAL LIABILITIES		**2,565,763,971**	3,501,055,416
EQUITY	17	**2,549,945,527**	2,402,632,556
TOTAL LIABILITIES AND EQUITY		**5,115,709,498**	5,903,687,972

The Notes on pages 8 to 41 form part of these financial statements.

SMALL BUSINESS CORPORATION
STATEMENT OF COMPREHENSIVE INCOME
For the year ended December 31, 2014
(In Philippine Peso)

	Note	2014	2013
INCOME			
Interest income from loans and receivables	7,8	**199,395,056**	218,094,841
Investment income	5,6	**91,193,426**	92,813,344
Guarantee fees	23	**2,142,140**	1,351,984
Other operating income		**20,489,037**	13,157,709
		313,219,659	325,417,878
FINANCE COST			
Interest expense on notes payable and other long-term borrowings	15	**100,763,256**	110,316,392
		100,763,256	110,316,392
INCOME BEFORE PROVISION FOR IMPAIRMENT OF LOANS		**212,456,403**	215,101,486
Provision for impairment of loans		**41,527,768**	22,946,141
		170,928,635	192,155,345
OTHER INCOME (LOSS)			
Other income		**25,666,060**	15,080,949
Realized foreign exchange gain/(loss)		**898,931**	(210,759)
		26,564,991	14,870,190
EXPENSES			
Administrative expenses	18	**180,251,989**	188,277,158
Other expenses			
Impairment loss on loans		**6,395**	-
Litigation expenses		**208,971**	627,004
Foreclosure and acquired assets expenses		**2,149,799**	1,227,053
		182,617,154	190,131,215
NET INCOME BEFORE INCOME TAX		**14,876,472**	16,894,320
PROVISION FOR INCOME TAX			
Current	21	**(3,632,353)**	(3,477,314)
Deferred	21	**20,982,540**	7,784,456
NET INCOME	**24**	**32,226,659**	21,201,462
OTHER COMPREHENSIVE INCOME (LOSS)			
Unrealized gain/(loss) on foreign exchange translation		**168,524,396**	42,587,246
Unrealized gain/(loss) on derivative valuation	9	**(53,438,084)**	(122,417,718)
		115,086,312	(79,830,472)
TOTAL COMPREHENSIVE INCOME (LOSS)		**147,312,971**	(58,629,010)
Support from National Government	26	**100,000,000**	-
Less:			
ERF expenses		4,736,766	-
Provision for probable losses-ERF		92,031,015	-
Total		**96,767,781**	-
Balance		3,232,219	-

The Notes on pages 8 to 41 form part of these financial statements.

SMALL BUSINESS CORPORATION
STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2014
(In Philippine Peso)

	Note	Capital Stock Common Shares	Capital Stock Preferred Shares	Additional Paid In Capital	Retained Earnings	Total
BALANCE AS AT January 01, 2013		1,519,902,000	400,000,000		461,849,106	2,381,751,106
Additional paid-in-capital	17.2			79,510,460		79,510,460
Prior period adjustments						
Net income for the year					21,201,462	21,201,462
Decrease in fair value adjustment					(79,830,472)	(79,830,472)
BALANCE AS AT December 31, 2013		1,519,902,000	400,000,000	79,510,460	403,220,096	2,402,632,556
Net income for the year					32,226,659	32,226,659
Increase in fair value adjustment					115,086,312	115,086,312
BALANCE AS AT December 31, 2014	17.1	**3,039,804,000**	**400,000,000**	**79,510,460**	**550,533,067**	**2,549,945,527**

The Notes on pages 8 to 41 form part of these financial statements.

SMALL BUSINESS CORPORATION
STATEMENT OF CASH FLOWS
For the year ended December 31, 2014
(In Philippine Peso)

	Note	2014	2013
Cash Flows from Operating Activities:			
Cash Inflows:			
Interest on loans		**183,859,717**	217,919,524
Interest on investments		**89,152,223**	91,889,081
Guarantee fees		**2,058,773**	1,037,083
Other income		**15,771,765**	12,039,278
Collections of employees loan		**7,182,308**	5,349,020
Advances/Refund from suppliers and creditors		**24,170,432**	690,872
Collection of loans		**2,339,757,278**	3,082,083,334
Payment received lodged under “Undistributed Collection”		**2,078,273**	980,333
Gain on foreign exchange		**1,558,664**	2,636,126
Total Cash Inflows		**2,665,589,433**	3,414,624,651
Cash Outflows:			
Payment of operating expenses	18	**111,037,975**	166,284,873
Advances to suppliers and creditors		**72,230**	193,586
Loans granted to employees		**9,124,337**	5,318,734
Loans granted	7,8	**2,074,537,536**	2,929,467,321
Loss on foreign exchange		**659,732**	2,846,886
Total Cash Outflows		**2,195,431,810**	3,104,111,400
Net Cash Provided by Operating Activities		**470,157,623**	310,513,251
Cash Flows from Investing Activities:			
Cash Inflows:			
Held-to maturity-investment	6	**469,543,130**	66,259,297
Disposal of investment property (ROPA)	11	**3,800,297**	3,019,444
Proceeds from sale of disposed assets (PE)	12	**43,334**	62,017
Total Cash Inflows		**473,386,761**	69,340,758
Cash Outflows:			
Held-to maturity-investment		**428,645,601**	374,919,986
Purchase of property and equipment (PE)	12	**3,136,257**	2,737,657
Investment in equity instruments	10	**7,880,000**	1,000,000
Foreclosed property	11	**4,790,907**	12,384,688
Total Cash Outflows		**444,452,765**	391,042,331
Net Cash Provided by (Used in) Investing Activities		28,933,996	(321,701,573)
Cash Flows from Financing Activities:			
Cash Inflows:			
Proceeds from borrowings:			
Issuance of MSME Notes to Banks/OFI	14	**585,523,547**	422,264,443
Foreign loans	15	**9,645,753**	50,324,699
Total Cash Inflows		**595,169,300**	472,589,142
Cash Outflows:			
Payment of foreign loans	15	**698,226,176**	102,563,555
Payment of interest on loans and other finance costs	15	**84,351,030**	76,334,035
Payment of matured MSME Notes and PS-ACMA Shares		**648,711,588**	150,823,796
Foreign exchange risk cover		**22,896,801**	46,442,798
Total Cash Outflows		**1,454,185,595**	376,164,184
Net Cash Provided by (Used in) Financing Activities		**(859,016,295)**	96,424,958
Net increase (decrease) in cash and cash equivalents		**(359,924,676)**	85,236,636
Add: Cash and cash equivalents, beginning		**507,012,483**	421,775,847
Cash and cash equivalents, ending		**147,087,807**	507,012,483

The Notes on pages 8 to 41 form part of these financial statements.

SMALL BUSINESS CORPORATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2014
(In Philippine Peso)

1. GENERAL INFORMATION

The Small Business Corporation (SBC) is a government corporation created on January 24, 1991 by virtue of Section 11 of Republic Act (RA) No. 6977, amended on May 6, 1997 by RA No. 8289, otherwise known as Magna Carta for Small and Medium Enterprises. SBC is under the policy program and administrative supervision of the Micro, Small and Medium Enterprise Development (MSMED) Council of the Department of Trade and Industry (DTI), the primary agency responsible for the promotion and development of small and medium enterprises in the country.

On May 23, 2008, the President of the Philippines signed into law RA No. 9501, titled "An Act to Promote Entrepreneurship by Strengthening Development and Assistance Programs to Micro, Small and Medium Scale Enterprises Amending for the Purpose Republic Act No. 6977, as amended, otherwise known as the "Magna Carta for Small and Medium Enterprises" and for other purposes". The law, among other items, increases the Corporation's authorized capital stock from P5 billion to P10 billion.

Section 11 of RA No. 9501 states that…"*Creation of Small Business Guarantee and Finance Corporation* – There is hereby created a body corporate to be known as the Small Business Guarantee and Finance Corporation, hereinafter referred to as the Small Business Corporation (SB Corporation), which shall be charged with the primary responsibility of implementing comprehensive policies and programs to assist MSMEs in all areas, including but not limited to finance and information services, training and marketing."

The principal office of SBC is at 139 Corporate Center, 139 Valero St., Salcedo Village, Makati City. It has four area offices, one unit office and 15 desk offices within the Philippines and has 137 and 139 regular employees for the calendar years 2014 and 2013, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1. Basis of financial statements preparation

The financial statements of the Corporation are prepared in accordance with the Philippine Financial Reporting Standards (PFRS).

(a) Statement of Compliance with Philippine Financial Reporting Standards

The financial statements of the Corporation have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are issued by the Financial Reporting Standards Council (FRSC) and approved by the Philippine Board of Accountancy (BOA) based on International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, income and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) Presentation of Financial Statements

The financial statements are presented in accordance with Philippine Accounting Standard (PAS) 1, *Presentation of Financial Statements*. The Company presents all items of income and expenses in a single statement of comprehensive income

The Corporation presents a third statement of financial position as at the beginning of the preceding period when it applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period.

(c) Functional and Presentation Currency

These financial statements are presented in Philippine pesos, the Corporation's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the financial statements of the Corporation are measured using its functional currency. Functional currency is the currency of the primary economic environment in which the Corporation operates.

2.2. <u>Adoption of New and Amended PFRS</u>

(a) Effective in 2014 that are Relevant to the Corporation

In 2014, the Corporation adopted for the first time the following amendments and interpretation to PFRS that are relevant to the Corporation and effective for financial statements for the annual period beginning on or after January 1, 2014:

PAS 32 (Amendment)	:	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities
PAS 36 (Amendment)	:	Impairment of Assets - Recoverable Amount Disclosures for Non-financial Assets
PAS 39 (Amendment	:	Financial Instruments: Recognition and Measurement–Novation of Derivatives and Continuation of Hedge Accounting
Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC) 21	:	Levies

Discussed below are the relevant information about these amended standards and interpretation.

(i) PAS 32 (Amendment), *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*. The amendment provides guidance to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. It clarifies that an entity must currently have a right of set-off that is not contingent on a future event, and must be legally enforceable in the normal course of business; in the event of default; and, in the event of insolvency or bankruptcy of the entity and all of the counterparties. The amendment also clarifies that gross settlement mechanisms (such as through a clearing house) with features that both eliminate credit and liquidity risks and process receivables and payables in a single settlement process, will satisfy the criterion for net settlement. The amendment has been applied retrospectively in accordance with its transitional provisions. The Corporation's existing offsetting and settlement arrangements for its financial instruments with its counterparties are not affected by the amendment; hence, such did not have an impact on the presentation of financial assets and financial liabilities on the Corporation's financial statements for any periods presented.

(ii) PAS 36 (Amendment), *Impairment of Assets – Recoverable Amount Disclosures for Non-financial Assets*. The amendment clarifies that disclosure of information about the recoverable amount of individual asset (including goodwill) or a cash-generating unit is required only when an impairment loss has been recognized or reversed during the reporting period. If the recoverable amount is determined based on the asset's or cash-generating unit's fair value less cost of disposal, additional disclosures on fair value measurement required under PFRS 13, *Fair Value Measurement*, such as but not limited to the fair value hierarchy, valuation technique used and key assumptions applied should be provided in the financial statements. This amendment did not result in additional disclosures in the financial statements since the recoverable amounts of the Corporation's non-financial assets where impairment losses have been recognized were determined based on value-in-use which have been adequately disclosed in accordance with PAS 36.

(iii) PAS 39 (Amendment), *Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting*. The amendment provides some relief from the requirements on hedge accounting by allowing entities to continue the use of hedge accounting when a derivative is novated to a clearing counterparty resulting in termination or expiration of the original hedging instrument as a consequence of laws and regulations, or the introduction thereof. As the Corporation neither enters into transactions involving derivative instruments nor does it applies hedge accounting, the amendment did not have any impact on the Corporation's financial statements.

(iv) Philippine Interpretation IFRIC 21, *Levies.* This interpretation clarifies that the obligating event as one of the criteria under PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, for the recognition of a liability for levy imposed by a government is the activity described in the relevant legislation that triggers the payment of the levy. Accordingly, the liability is recognized in the financial statements progressively if the obligating event occurs over a period of time and if an obligation is triggered on reaching a minimum threshold, the liability is recognized. This amendment had no significant impact on the Corporation's financial statements.

(b) Effective in 2014 that are not Relevant to the Corporation

Among the amendments to PFRS which are effective for the annual period beginning or after January 1, 2014, the Amendments to PFRS 10, *Consolidated Financial Statements*, PFRS 12, *Disclosure of Interests in Other Entities*, and PAS 27, *Separate Financial Statements*, in relation to the exception from consolidation for an investment entity of its investments in subsidiaries are not relevant to the Corporation.

(c) Effective Subsequent to 2014 but not Adopted Early

There are new PFRS, amendments and annual improvements to existing standards effective for annual periods subsequent to 2014 which are issued by the FRSC, subject to the approval of the BOA. Management will adopt the following relevant pronouncements in accordance with their transitional provisions, and, unless otherwise stated, none of these are expected to have significant impact on the Corporation's financial statements:

(i) PAS 19 (Amendment), *Employee Benefits – Defined Benefit Plans – Employee Contributions* (effective from July 1, 2014). The amendment clarifies that if the amount of the contributions from employees or third parties is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method (i.e., either using the plan's contribution formula or on a straight-line basis) for the gross benefit.

(ii) PAS 1 (Amendment), *Presentation of Financial Statements – Disclosure Initiative* (effective from January 1, 2016). The amendment encourages entities to apply professional judgment in presenting and disclosing information in the financial statements. Accordingly, it clarifies that materiality applies to the whole financial statements and an entity shall not reduce the understandability of the financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions. Moreover, the amendment clarifies that an entity's share of other comprehensive income of associates and joint ventures accounted for using equity method should be presented based on whether or not such other comprehensive income item will subsequently be reclassified to profit or loss. It further clarifies that in determining the order of presenting the notes and disclosures, an entity shall consider the understandability and comparability of the financial statements.

(iii) PAS 16 (Amendment), *Property, Plant and Equipment* and PAS 38 (Amendment), *Intangible Assets – Clarification of Acceptable Methods of Depreciation and Amortization* (effective from January 1, 2016). The amendment in PAS 16 clarifies that a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate for property, plant and equipment. In addition, amendment to PAS 38 introduces a rebuttable presumption that an amortization method that is based on the revenue generated by an activity that includes the use of an intangible asset is not appropriate, which can only be overcome in limited circumstances where the intangible asset is expressed as a measure of revenue, or when it can be demonstrated that revenue and the consumption of the economic benefits of an intangible asset are highly correlated.

(iv) PAS 16 (Amendment), *Property, Plant and Equipment* and PAS 41 (Amendment), *Agriculture – Bearer Plants* (effective from January 1, 2016). The amendment defines a bearer plant as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. On this basis, bearer plant is now included within the scope of PAS 16 rather than PAS 41, allowing such assets to be accounted for as property, plant and equipment and to be measured after initial recognition at cost or revaluation basis in accordance with PAS 16. The amendment further clarifies that produce growing on bearer plants remains within the scope of PAS 41.

(v) PAS 27 (Amendment), *Separate Financial Statements – Equity Method in Separate Financial Statements* (effective from January 1, 2016). This amendment introduces a third option which permits an entity to account for its investments in subsidiaries, joint ventures and associates under the equity method in its separate financial statements in addition to the current options of accounting those investments at cost or in accordance with PAS 39 or PFRS 9, *Financial Instruments*.

(vi) PAS 28 (Amendment), *Investments in Associates and Joint Ventures – Investment Entities – Applying the Consolidation Exception* (effective from January 1, 2016). This amendment addresses the concerns that have arisen in the context of applying the consolidation exception for investment entities. This amendment permits a non-investment entity investor, when applying the equity method of accounting for an associate or joint venture that is an investment entity, to retain the fair value measurement applied by that investment entity associate or joint venture to its interests in subsidiaries.

(vii) PFRS 10 (Amendment), *Consolidated Financial Statements* and PAS 28 (Amendment), *Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associates or Joint Venture* (effective from January 1, 2016). The amendment to PFRS 10 requires full recognition in the investor's financial statements of gains or losses arising on the sale or contribution of assets that constitute a business transaction as defined in PFRS 3, *Business Combinations*, between an investor and its associate or joint venture. Accordingly, the partial recognition of gains or losses (i.e., to the extent of the unrelated investor's interests in an associate or joint venture) only applies to those sale of contribution of assets that do not constitute a business transaction. Corresponding amendment has been made to PAS 28 to reflect these changes. In addition, PAS 28 has been amended to clarify that when determining whether assets that are sold or contributed constitute a business transaction, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.

(viii) PFRS 9 (2014), *Financial Instruments* (effective from January 1, 2018). This new standard on financial instruments will eventually replace PAS 39 and PFRS 9 (2009, 2010 and 2013 versions). This standard contains, among others, the following:

- three principal classification categories for financial assets based on the business model on how an entity is managing its financial instruments;

- an expected loss model in determining impairment of all financial assets that are not measured at fair value through profit or loss (FVTPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset; and,

- a new model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures.

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

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

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

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

The Corporation does not expect to implement and adopt any version of PFRS 9 until its effective date. In addition, management is currently assessing the impact of PFRS 9 on the financial statements of the Corporation and it will conduct a comprehensive study of the potential impact of this standard prior to its mandatory adoption date to assess the impact of all changes.

(ix) Annual Improvements to PFRS. Annual improvements to PFRS (2010-2012 Cycle) and PFRS (2011-2013 Cycle) effective for annual periods beginning on or after July 1, 2014, and to PFRS (2012-2014 Cycle) effective for annual periods beginning on or after July 1, 2016, made minor amendments to a number of PFRS. Among those improvements, the following amendments are relevant to the Corporation but management does not expect those to have material impact on the Corporation's financial statements:

Annual Improvements to PFRS (2010-2012 Cycle)

(a) PAS 16 (Amendment), *Property, Plant and Equipment* and PAS 38 (Amendment), *Intangible Assets.* The amendments clarify that when an item of property, plant and equipment, and intangible assets is revalued, the gross carrying amount is adjusted in a manner that is consistent with a revaluation of the carrying amount of the asset.

(b) PAS 24 (Amendment), *Related Party Disclosures*. The amendment clarifies that an entity providing key management services to a reporting entity is deemed to be a related party of the latter. It also clarifies that the information required to be disclosed in the financial statements are the amounts incurred by the reporting entity for key management personnel services that are provided by a separate management entity and not the amounts of compensation paid or payable by the management entity to its employees or directors.

(c) PFRS 13 (Amendment), *Fair Value Measurement*. The amendment in the basis of conclusion of PFRS 13 clarifies that issuing PFRS 13 and amending certain provisions of PFRS 9 and PAS 39 related to discounting of financial instruments did not remove the ability to measure short-term receivables and payables with no stated interest rate on an undiscounted basis, when the effect of not discounting is immaterial.

Annual Improvements to PFRS (2011-2013 Cycle)

(a) PFRS 13 (Amendment), *Fair Value Measurement*. The amendment clarifies that the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the portfolio exception) applies to all contracts within the scope of and accounted for in accordance with PAS 39 or PFRS 9, regardless of whether they meet the definition of financial assets or financial liabilities as defined in PAS 32.

(b) PAS 40 (Amendment), *Investment Property*. The amendment clarifies the interrelationship of PFRS 3 and PAS 40 in determining the classification of property as an investment property or owner-occupied property, and explicitly requires an entity to use judgment in determining whether the acquisition of an investment property is an acquisition of an asset or a group of asset in accordance with PAS 40, or a business combination in accordance with PFRS 3.

Annual Improvements to PFRS (2012-2014 Cycle)

(a) PFRS 5 (Amendment), *Non-current Assets Held for Sale and Discontinued Operations.* The amendment clarifies that when an entity reclassifies an asset (or disposal group) directly from being held for sale to being held for distribution (or vice-versa), the accounting guidance in paragraphs 27-29 of PFRS 5 does not apply. It also states that when an entity determines that the asset (or disposal group) is no longer available for immediate distribution or that the distribution is no longer highly probable, it should cease held-for-distribution accounting and apply the guidance in paragraphs 27-29 of PFRS 5.

(b) PFRS 7 (Amendment), *Financial Instruments – Disclosures*. The amendment provides additional guidance to help entities identify the circumstances under which a contract to “service” financial assets is considered to be a continuing involvement in those assets for the purposes of applying the disclosure requirements of PFRS 7. Such circumstances commonly arise when, for example, the servicing is dependent on the amount or timing of cash flows collected from the transferred asset or when a fixed fee is not paid in full due to non-performance of that asset.

(c) PAS 19 (Amendment), *Employee Benefits*. The amendment clarifies that the currency and term of the high quality corporate bonds which were used to determine the discount rate for post-employment benefit obligations shall be made consistent with the currency and estimated term of the post-employment benefit obligations.

2.3. Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and in banks, working funds, demand deposits, with short-term, highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value, having been within three months of maturity when placed or acquired.

2.4. Financial assets

The Corporation classifies its financial assets in the following categories: financial assets at fair value through profit or loss, held-to-maturity investments; loans and receivable. Management determines the classification of its investments at initial recognition and where appropriate, re-evaluates such classification at every reporting date. When financial assets are recognized initially, they are measured at fair value, plus directly attributable transaction costs in the case of investments not measured at fair value through profit or loss.

Acquisition and disposal of financial assets are recognized on the transaction date - the date on which the Corporation commits to acquire or dispose the asset. Loans and receivables are recognized when cash is advanced for direct loans to banks and individual borrowers.

a. Held-to-maturity investments

Held-to-maturity (HTM) investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Corporation's management has the positive intention and ability to hold to maturity. These investments are carried at amortized cost using the effective interest rate method, less impairment in value. Gains and losses are recognized in the income statement when the HTM are derecognized and impaired, as well as through the amortization process.

b. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are initially recognized at fair value. After initial measurement, these are subsequently measured at amortized cost using the effective interest method less provision for impairment. The amortization is included under interest income from loans and receivables in the statement of income. The losses arising from impairment/allowance for doubtful accounts are recognized in the statement of income and expenses.

c. Financial assets at fair value through profit or loss

The currency risk of the Corporation on account of its foreign currency denominated borrowings is covered by the National Government through the Department of Finance (DOF) via a foreign exchange risk cover throughout the life of the loan at a cost of three per cent per annum on the outstanding balance. This is recorded in the books as derivative assets with fixed maturities whose value changes in response to the change in specific interest rate, financial instrument price, foreign exchange rate, index of prices of rates. For valuation purposes, the Corporation adopts the currency option using the Black-Scholes Option Model as its pricing valuation model. Changes in fair value are recognized in the statement of comprehensive income.

2.5. Financial liability

Financial liabilities include bank loans, trade and other payables, and due to government agencies/institutions.

Financial liabilities are recognized when the Corporation becomes a party to the contractual agreements of the instrument. All interest and related charges are recognized as an expense in the statement of comprehensive income under the caption Finance Cost while the foreign exchange risk cover fee is capitalized under the Financial Assets at Fair Value through Profit or Loss.

Bank loans are raised for support of short and long-term funding of operations. They are recognized at proceeds received, net of direct issue costs. Finance charges, including direct issue costs, are charged to profit or loss on an accrual basis using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Notes payable are obligations of SBC to various financial institutions arising from its issuance of Micro, Small and Medium Enterprises (MSME) Notes in the nature of promissory notes deemed as alternative compliance to the mandatory allocation provision under Section 13 of Republic Act No. 6977 as amended by Republic Act Nos.
8289 and 9501.

Trade payables are recognized initially at their nominal value and subsequently measured at amortized cost less settlement payments.

Dividend distributions to the stockholders are recognized as financial liabilities.

2.6. Impairment of financial instruments

Assets are impaired if carrying amount exceeds the amount to be recovered through use or sale of the asset. An assessment is made at each statement of financial position date whether there is objective evidence that a specific financial or non-financial asset maybe impaired. If such evidence exists, any impairment loss is recognized in the statement of comprehensive income.

a. Impairment of financial assets

If there is evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of loss is measured as the difference between the carrying amount and the present value of estimated cash flows discounted at the original effective interest rate. The carrying amount of the asset shall be reduced either directly or through the use of allowance account. The amount of loss is charged to the statement of comprehensive income.

If in subsequent year, the amount of impairment loss decreases because of the event occurring after the impairment is recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of the impairment loss is recognized in the statement of comprehensive income.

b. Impairment of non-financial assets

Where an indicator of impairment exists, the Corporation makes a formal estimate of recoverable amount. An asset’s recoverable amount is the higher of an asset’s cash generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Impairment losses are recognized in the statement of comprehensive income in those expenses categories consistent with the function of the impaired assets.

2.7. Derecognition of financial instruments

a. Financial assets

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

1. The rights to receive cash flows from the asset have expired;

2. The Corporation retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-though" arrangement; or

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

When the Corporation has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Corporation's continuing involvement in the asset.

b. Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or had expired.

2.8. Investment in equity instruments

The Corporation invests for current income, capital appreciation, development impact, or all three; the Corporation does not take operational, controlling, or strategic positions with its investees. Equity investments are acquired through direct ownership of equity instruments of investees and are recorded at cost as at date when the investor entity becomes a party to the contractual provisions of the instrument.

If there is objective evidence that an impairment loss has been incurred on the equity instrument, the amount of impairment is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

2.9. Investment property

Investment property are booked initially at the carrying amount of the loan (outstanding loan balance less allowance for credit losses computed based on PAS 39, Financial Instruments: Recognition and Measurement provisioning requirements, which take into account the fair value of the collateral) plus booked accrued interest less allowance for credit losses (computed based on PAS 39 provisioning requirements) plus transaction costs incurred upon acquisition. Subsequently, the carrying amount of the acquired assets is subject to depreciation and impairment testing (computed based on PAS 36, Impairment of Assets) reckoning from the time of acquisition. Transaction costs including taxes such as capital gains tax and documentary stamp tax paid by the Corporation are capitalized as part of cost. Buildings and other non-financial assets are depreciated over the remaining useful life of the assets, which shall not exceed ten years and three years from the date of acquisition, respectively.

Expenditures incurred to protect and maintain these investment properties, such as real estate taxes, insurance, repairs and maintenance costs, are normally charged against current operation in the period in which cost is incurred.

Investment property are derecognized when they have either been disposed of or when the investment properties are permanently withdrawn from use and no future benefit is expected from their disposal. Any gains or losses on retirement or disposal of an investment property are recognized in the statement of comprehensive income in the year of retirement or disposal.

2.10. Property and equipment

The Corporation's depreciable property are stated at cost less accumulated depreciation and any impairment in value.

The initial cost of property and equipment consists of its purchase price, including taxes and any directly attributable costs of bringing the asset to its working condition and intended use. Expenditures incurred after items of property and equipment have been put into operation, such as repairs and maintenance, are charged against operations in the year in which the costs are incurred. When property and equipment are retired or otherwise disposed of, the cost and the related accumulated depreciation and amortization are removed from the accounts, and any resulting gain or loss is reflected as income or loss in the statement of comprehensive income.

Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets (cost less residual value over useful life). Leasehold improvements are amortized over the shorter of the terms of the covering leases and the estimated useful lives of the improvements.

The estimated useful life of the respective asset follows:

Condominium unit and leasehold improvements	10-30 years
Office furniture and fixtures	10 years
Business machines and equipment	5 years
Transportation equipment	7 years

The carrying values of the property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, an impairment loss is recognized in the statement of comprehensive income.

2.11. Intangible assets

Intangible assets are stated in the financial statements at cost less accumulated amortization and any impairment in value. They comprise of software licenses, among others.

The Corporation adopted the straight-line amortization method for the intangible assets over five years. The carrying amount of the intangible assets is subject to review for impairment when events or changes in the circumstances indicate that the carrying amount might exceed their recoverable amount. Impairment losses are then included in the statement of comprehensive income.

2.12. Borrowing costs

Borrowing costs represent interest and other pertinent financial charges and costs incurred in connection with the availments of domestic and foreign borrowings. In compliance with PAS 23, that prescribes the accounting treatment for borrowing costs, such costs are generally recognized and accrued as an expense in the period in which they are incurred.

2.13. Revenue and cost recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Corporation and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

a. Interest on loans

Interest income on loans are recorded as income on an accrual basis. Loan origination costs are expensed as incurred. Loan origination fees and other processing fees are recognized as income when received. The Corporation does not recognize income on loans when collectibility is in doubt or payments of interest or principal are past due in accordance with the Bangko Sentral ng Pilipinas (BSP) guidelines unless Management anticipates that collection of interest will occur in the near future. Any interest accrued on a loan placed in non-accrual status is reversed out of income and is thereafter recognized as income only when the actual payment is received. Interest not previously recognized but capitalized as part of a debt restructuring is recorded as deferred income included in the balance sheet in payables and other liabilities, and credited to income only when the related principal is received.

b. Investment income

Interest on interest-bearing placements and securities are recognized as the interest accrues, taking into account the effective yield on such assets. This includes gain and losses from fair value measurements.

Cost and expenses are recognized in the statement of comprehensive income upon utilization of the service or at the date they are incurred. Finance costs are reported on an accrual basis.

c. Guarantee fees

The Corporation extends financial guarantee facilities to its clients to provide credit enhancement for their debt securities and trade obligations. Under the terms of the guarantee, the Corporation agrees to assume responsibility for the client's financial obligations in the event of default by the client (i.e. failure to pay when payment is due). Guarantees are regarded as issued when the Corporation commits to the guarantee. This date is also the "inception" of the guarantee contract. Guarantees are regarded as outstanding when the underlying financial obligation of the client is incurred and called when the Corporation's obligation under the guarantee has been invoked.

When the guarantees are called, the amount disbursed is recorded as a guarantee paid account, and specific reserves are established based on the estimated probable loss. These reserves are included in the reserve against losses on loans in the statement of financial position. Guarantee fees are recorded as income as the stand-ready obligation to perform is fulfilled.

2.14. Employee benefit plan

The Corporation has a Provident Fund consisting of contributions made both by its officers and employees and the Corporation. Corporate contribution is vested to the employee after completing five years of service in the Corporation. Details of the employee benefits are discussed in Note 19.

2.15. Leases

Finance leases, which transfer to/from the Corporation substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are included as interest expense in the statement of comprehensive income.

Capital leased assets are depreciated over the shorter of the estimated useful lives of the assets or the respective lease terms.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating lease. Operating lease payments are recognized as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

2.16. Income taxes

Current tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in the statement of comprehensive income.

Deferred tax is provided, using the balance sheet method on temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the balance sheet method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets which are recognized for all deductible temporary differences and the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred income tax asset can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.
Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date.
Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in the statement of comprehensive income. Only changes in deferred tax assets or liabilities that relate to a change in value of assets or liabilities are charged or credited directly to equity.

2.17. Functional currency and foreign currency transactions

a. Functional and presentation currency

Items included in the financial statements of the Corporation are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The financial statements are presented in Philippine pesos, which is the Corporation’s functional and presentation currency.

b. Transactions and balances

The accounting records of the Corporation are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates (BSP rate) which approximate those prevailing on transaction dates. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive income.

2.18. Financial risk management

The Corporation is exposed to a variety of financial risks such as market risk (including currency risk, interest rate risk and price risk), credit risk, and liquidity risk.

The financial risks are identified, measured and monitored through various control mechanisms to assess adequately the market circumstances to avoid disastrous financial consequences to the Corporation. The Corporation's risk management policies are summarized below:

Financial risk factors

a. Market risk – interest rate risk/currency risk

The Corporation measures and manages its interest rate sensitivity position to ensure its long-run earning power and build-up of its investment portfolio. Special emphasis is placed on the change in net interest income/expense that will result from possible fluctuations in interest rates, changes in portfolio mix and tenor.

The Corporation manages its currency risk against the foreign exchange rate fluctuations on its foreign currency denominated borrowings through a foreign exchange risk cover secured from the Department of Finance at a given cost for the term of the loan.

The Corporation's exposure to market risk for changes in interest rates relates primarily to the Corporation's loans from various financial institutions.

b. Credit risk

In view of its mandate to safeguard the interest of the public and contribute in the promotion of stability in the economy, credit risk to the Corporation is the risk that the loans granted to borrowers and/or other financial institutions will not be paid when due.

Therefore, the Corporation exercises prudence in the grant of loans over its exposures to credit risk. This is managed through the implementation of the borrower risk rating and monitoring of the loan covenants in the loan agreements. The Corporation likewise mitigates such risk through the provision of secondary source of payment (collateral).

c. Liquidity risk

The Corporation seeks to manage its liquidity profile to be able to finance capital expenditures and service maturing debts. To cover its financing requirements, the Corporation intends to use internally generated funds and available long-term and short-term credit facilities.

As part of its liquidity risk management, the Corporation regularly evaluates its projected and actual cash flows. It also continuously assesses conditions in the financial markets for

OPPORTUNITIES TO PURSUE FUND RAISING ACTIVITIES, IN CASE ANY REQUIREMENTS ARISE. FUND RAISING activities may include bank loans and capital market issues.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the financial statements in accordance with PAS/PFRS requires the Corporation to make estimates and assumptions that affect the reported amounts of resources, liabilities, income and expenses and disclosure of contingent resources and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. While the estimates are based on the most reliable data available, actual results, in the near term, could differ significantly from those estimates depending upon certain events and uncertainties including:

- The extent to which the Corporation can maximize the sale and recoveries from the assets it acquire as foreclosed from borrowers;
- The probability of recovery through successful lawsuits as appropriate against relevant parties.

3.1. Contingencies

The Corporation is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of these claims has been developed in consultation with counsel handling and monitoring the defense in these matters and is based upon an analysis of potential results.

The Corporation currently does not believe that these proceedings will have a material adverse effect on its financial position. It is possible, however, that future results of operations could be materially affected by the changes in the estimates.

3.2. HTM financial assets

The Corporation classifies non-derivative financial assets with fixed or determinable payments and fixed maturity as HTM investment. This classification requires significant judgment. In making this judgment, the Corporation evaluates its intention and ability to hold such investments to maturity. If the Corporation fails to keep these investments to maturity other than in certain specific circumstances, it will be required to reclassify the entire portfolio to Available for Sale (AFS) investments. The investments would therefore be measured at fair value and not at amortized cost.

3.3. Allowance for loan impairment/doubtful accounts

The Corporation reviews its loans and receivables to assess potentially uncollectible receivables annually. In determining the level of allowance, the Corporation makes judgments as to whether there is any observable development and information indicating that there is a measurable decrease in the estimated future cash flows from the loans and receivables. The Corporation observes BSP criteria and guidelines on the classification of receivables in establishing specific loan loss reserves/provisioning.

3.4. Impairment loss on investment property

The Corporation assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Corporation recognizes an impairment loss/provision for probable loss whenever the carrying amount of an asset exceeds the recoverable amount.

3.5. Estimated useful lives of property and equipment and investment property

The Corporation uses the prescribed estimated useful lives of Property and Equipment and Investment Property by the Commission on Audit (COA).

4. EVENTS AFTER BALANCE SHEET DATE

Post year events that provide additional information about the Corporation's position at the statement of financial position date (adjusting events) are reflected in the Financial Statements. Post year events that are non-adjusting events are disclosed in the Notes to Financial Statements when material.

5. CASH AND CASH EQUIVALENTS

The account consists of the following:

	2014	2013
Cash in bank a/	**142,028,127**	59,012,483
Short-term investments b/	**5,059,680**	448,000,000
	147,087,807	507,012,483

a/ The account consists of the following:

- Funds deposited with government banks for payroll and corporate operating funds;
- Cash in banks earns interest at rates based on average monthly deposit balances.

b/ This account refers to investments maturing within three months from transaction date with interest of 2.5 per cent per annum for 2014 and 0.05 per cent to 1.35 per cent per annum for 2013. (Note 2.3)

6. HELD-TO-MATURITY (HTM) INVESTMENTS

Funds, which are not yet earmarked for loan releases, operating and other administrative expenses are temporarily invested in government securities consisting of treasury bills, fixed and retail treasury bonds, and dollar time deposits with the Land Bank of the Philippines (LBP), Development Bank of the Philippines (DBP) and the Bureau of the Treasury (BTr). These investments have various maturity dates over three months at rates ranging from 1.625 per cent per annum to 9.125 per cent per annum for 2014.

Government securities worth P202,720,000 are covered by a Deed of Assignment of Government Securities as security for the payment of principal and interest as the faithful performance by the Corporation of its obligations to the various financial institutions under the Micro, Small and Medium Enterprise (MSME) Notes. This Deed and other related documents are discussed in Notes 14.

Investment in Treasury Bills – Guarantee Reserve Fund (GRF), as shown below, represents the sinking fund equivalent of the GRF (see Note 22) as at December 31, 2014.

	2014	2013
Investments in treasury bills	**1,484,845,646**	1,519,126,837
Investments in treasury bills - GRF	**256,228,719**	262,411,432
Investments in bonds	**601,182**	648,866
Interest receivable on investments	**22,646,530**	20,160,596
	1,764,322,077	1,802,347,731
Short-term	**92,548,042**	236,904,028
Long-term	**1,671,774,035**	1,565,443,703

7. DUE FROM BANKS AND OTHER FINANCING INSTITUTIONS - NET

The Corporation extends loans to banks and other financing institutions at an interest rate ranging from 4.5 per cent to 10.5 per cent per annum for relending under SBC special lending programs for micro, small and medium enterprises.

Details of the loan portfolio are as follows:

	2014	2013
Wholesale financing	**1,910,514,045**	2,439,229,208
Less: Allowance for doubtful accounts	**194,213,524**	166,981,457
Net	**1,716,300,521**	2,272,247,751
Current	**1,651,841,067**	2,004,207,636
Long-tem	**64,459,454**	268,040,115

8. LOANS AND RECEIVABLES - NET

The account consists of the following:

	2014	2013
Loans receivable – retail a/	**742,891,153**	706,378,837
Loans receivable –ERF b/	**250,907,046**	-
Loans receivable - others	**53,577,847**	40,063,292
Interest receivable – loans	**41,985,777**	34,249,960
	1,089,361,824	780,692,089
Less: allowance for doubtful accounts	**235,975,416**	128,771,006
	853,386,408	651,921,083
Guarantee paid accounts c/	**76,662,989**	76,350,987
Less: allowance for doubtful accounts	**73,621,433**	72,509,322
	3,041,556	3,841,665
Accounts receivable – others d/	**29,345,764**	35,109,487
Less: allowance for doubtful accounts	**880,000**	10,871,198
	28,465,764	24,238,289
Net	**884,893,728**	680,001,037
Current	**523,146,569**	457,006,126
Long-term	**361,747,159**	222,994,911

a/ Loans receivable – retail carry interest rates ranging from 6.5 per cent to 16 per cent per annum as at December 31, 2014.

b/ Loans receivable – ERF represents soft loans extended to micro and small enterprises located in calamity hit area such as those devastated by typhoon Yolanda and carry interest rate ranging from 5.0 percent to 8.0% per annum.

c/ Guarantee paid accounts – net, represents the amount paid by SBC to banks for the unpaid loans of its SBC guaranteed borrowers who defaulted in their regular loan amortizations to the banks concerned.

d/ Accounts receivable – others consists of the following:

	2014	2013
Agricultural Credit Policy Council (ACPC) re: Administrative fee for the Comprehensive Agricultural Loan Fund (CALF) c. 1.	**17,600,000**	21,742,396
Participating financial institution's share in expenses relative to foreclosure in the management of acquired assets	**11,745,764**	13,367,091
	29,345,764	35,109,487

c.1. This represents unclaimed administrative fees as at June 1, 2001 from ACPC for the CALF which was transferred to Quedan and Rural Credit Guarantee Corporation (QUEDANCOR) on June 18, 2001. Pursuant to Section 5 of Department of Agriculture (DA)

Administrative Order (AO) No. 10, series of 2001, the transfer of said CALF carries an obligation of QUEDANCOR, attached as a colatilla, to answer for the liability of such fund in accordance with the Memorandum of Agreement (MOA) between DA-ACPC and the GFSME (now SBC), that is the payment of administrative fees.

9. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

The account consists of the following:

	2014	2013
Asian Development Bank loan (JPY)	**57,876,615**	136,980,839
German Development Bank loan (EUR)	**184,947,393**	161,158,113
	242,824,008	298,138,952

The Financial assets at fair value through profit or loss account carry interest rates at December 31, 2014 and 2013, as follows:

	2014	2013
Foreign – JPY	0.03 – 0.31%	0.08% - 1.73%
- EUR	0.12 – 1.32%	0.20% - 2.74%

The Financial assets at fair value through profit or loss represents the fair value of the foreign exchange risk cover (FXRC) of the Corporation's borrowings from multilateral agencies amounting to P1.289 billion in 2014 and P1.555 billion in 2013 which is treated as derivative financial instrument. (see Note 15)

Under a MOA between the National Government through the Department of Finance, and SBC, the former guarantees and assumes the foreign exchange risk relating to SBC foreign currency denominated borrowings from the Asian Development Bank (ADB) and German Development Bank (KfW). In consideration thereof, SBC shall pay the National Government a guarantee fee of one per cent per annum and a FXRC fee of three per cent per annum.

The fair value changes on the FXRC are reported in the statement of comprehensive income. As at December 31, 2014, the outstanding notional amount of FXRC amounted to JPY 1.763 billion and EUR 11.700 million.

In 2014, as in previous years, the Corporation applied the Black-Scholes Option Model which resulted in financial assets at fair value through profit or loss of P242,824,008 and an unrealized loss on derivative valuation of P53,438,084 net of P1,876,860 recovery from the national government during the years.

10. INVESTMENT IN EQUITY INSTRUMENTS - NET

The account represents the Corporation's Equity Ventures Program, an equity financing program for Small and Medium Enterprises (SMEs) which calls for the participation of a private sector venture or equity capital company which will match the investment of the

Corporation in selected SME corporations. The Corporation, in cooperation with various SME corporations invested an aggregate amount of P16,817,620 for 11.25 to 48 per cent ownership engaged in the manufacture of acoustic and padded fabric wall and ceiling system; Citronella Home Essences and Insect Repellant organic fertilizer manufacturing; fabrication, rental and trading of generator sets, catering and lodging house services and Seaweeds production. This account is presented herewith net of P1,726,045 impairment provision as at December 31, 2014.

11. INVESTMENT PROPERTY - NET

The account consists of real and other properties acquired in settlement of receivables and guarantee paid accounts from borrowers.

Details are as follows:

	2014	2013
Real and other properties acquired	**179,436,973**	190,720,766
Less: Equity of originating financial institutions on acquired assets	**2,090,551**	4,247,423
Allowance for probable losses	**18,205,083**	18,241,826
Accumulated depreciation	**22,199,224**	23,638,377
	136,942,115	144,593,140

12. PROPERTY AND EQUIPMENT - NET

The account consists of the following:

	Land	Condo Unit and Leasehold	Furniture & Other Equipment	Transp. Equipment	TOTAL
Cost					
January 1, 2014	**901,623**	**141,395,114**	**27,355,187**	**14,185,795**	**183,837,719**
Additions	-	533,677	2,583,579	-	3,117,256
Adjustments	-	-	(119,011)	893,062	774,050
Disposals	-	-	(143,914)	(620,965)	(764,879)
December 31, 2014	**901,623**	**141,928,791**	**29,675,840**	**14,457,892**	**186,964,146**
Accumulated Depreciation					
January 1, 2014	-	**73,163,697**	**19,376,748**	**8,200,562**	**100,741,007**
Additions	-	4,077,857	1,972,231	1,232,083	7,282,171
Adjustments	-	-	(20,033)	(990)	(21,023)
Reclassification	-	-	-	5,753	5,753
Disposals	-	-	(98,477)	(557,053)	(655,530)
December 31, 2014	-	**77,241,554**	**22,230,467**	**8,880,355**	**107,352,377**
Book Value December 31, 2014	**901,623**	**64,687,236**	**8,445,374**	**5,577,537**	**79,611,769**
Book Value December 31, 2013	**901,623**	**68,231,417**	**7,978,439**	**5,985,233**	**83,096,712**

13. OTHER ASSETS

The account consists of the following:

	2014	2013
Deferred tax assets	**101,569,608**	80,587,069
Motor vehicle lease purchase plan (MVLPP)	**12,297,775**	11,857,339
Prepayments	**9,297,418**	11,966,631
Receivables - officers and employees	**1,246,639**	498,873
Guarantee deposit	**769,993**	703,790
Office supplies	**346,076**	201,430
Due from BMBE	**198,270**	844,626
Library books	**195,736**	195,736
Other assets	**2,714,383**	1,182,172
	128,635,898	108,037,666

14. NOTES PAYABLE / PREFERRED SHARES

The account consists of the following:

	2014	2013
Notes Payable[a/]		
Various MSME Development Partners	**1,175,395,326**	1,238,286,383
Current portion	**1,143,848,948**	1,190,187,323
Non-current portion	**31,546,378**	48,099,060

a/ The Notes payable represents the obligations of SBC to various financial institutions arising from its issuance of Micro, Small and Medium Enterprises (MSME) Notes in the nature of promissory notes (PNs) deemed as alternative compliance to the mandatory allocation provision under Section 13 of RA No. 6977 as amended by RA Nos. 8289 and 9501. Of the total MSME Notes issued, P329.700 million worth of PNs were secured by P202.720 million worth of government securities as at December 31, 2014.

The interest rate of the promissory notes ranges from 0.95 per cent to 2.57 per cent per annum for 2014.

15. LONG - TERM LIABILITIES

The account consists of the following:

	2014	2013
Foreign Currency Denominated Loans		
Asian Development Bank (ADB) [a/]	**653,201,446**	844,169,948
Kreditanstalt fur Weiderafbau (KfW) [b/]	**635,766,300**	711,548,370
	1,288,967,746	1,555,718,318
Peso Denominated Loans		
International Fund for Agricultural Development (IFAD) [c/]	**31,083,075**	621,437,322
	1,320,050,821	2,177,155,640
Current portion	**84,824,936**	97,024,528
Non-current portion	**1,235,225,885**	2,080,131,112

a/ The loan from ADB is a US $25 million (JPY 2.746 billion) denominated loan for Small and Medium Enterprises Development Support Project guaranteed by the Republic of the Philippines. The loan is on a 15 year term payable with a grace period of 36 months and carries an interest rate of JPY LIBOR plus 0.60 per cent per annum and a commitment fee of 0.75 per cent per annum on the unutilized portion of the loan. The conversion rate of Yen to Peso as at December 31, 2014 was at P0.3706. The loan was fully availed in 2009.

b/ The loan from the KfW is an 11.7 million Euro denominated loan for the purpose of financing loan for micro, small and medium sized private enterprises located mainly in Mindanao and Visayas. The loan is guaranteed by the Republic of the Philippines and bears an interest rate of 0.75 per cent per annum plus a commitment fee of 1/4 per cent per annum based on the undisbursed loan amount. The loan shall be amortized on a semi-annual basis for 40 years with a principal grace period of 10 years. The conversion rate of Euro to Peso as at December 31, 2014 was at P54.339. The loan was fully availed in 2010.

In consideration of the government guarantee and assumption of the foreign exchange risk for both loans, SBC in addition to the guarantee fee of one per cent, shall pay the National Government a foreign exchange risk cover fee of three per cent or the difference between the weighted average interest rate (WAIR) and total cost of funds (which includes ADB cost, guarantee fee and SBC's operational expense/spread) whichever is higher based on the outstanding principal balance of the loan.

As at December 31, 2014, the outstanding balance of ADB and KfW loans amounted to JPY 1.763 billion and Euro 11.700 million, respectively.

c/ The loan from the International Fund for Agricultural Development (IFAD) is a subsidiary loan from the Republic of the Philippines in peso amount equivalent to 10 Million Special Drawing Rights (SDR 10,000,000) to finance the implementation of the Rural Micro-Enterprise Promotion Programme (RuMEPP). The loan is on a 25 year term inclusive of eight years grace period on principal repayment and carries an interest rate of 4.75 per cent per annum payable on a semi-annual basis. As at December 31, 2014 the project was already completed.

16. OTHER CURRENT LIABILITIES

The account consists of the following:

	2014	2013
Accounts payable and accrued expenses	**49,146,770**	67,179,198
Deferred interest income	**19,092,781**	17,453,86
Undistributed collection	**2,078,273**	980,334
	70,317,824	85,613,393

Accounts payable and accrued expenses pertains to payables to suppliers and those payable to other agencies such as employee/employer premiums due to the Government Service and Insurance System (GSIS), Philippine Health Insurance Corporation (PhilHealth), Home Development Mutual Fund (HDMF) and taxes due to the Bureau of Internal Revenue (BIR). This account also includes interest payable on MSME notes as well as in foreign and domestic borrowings.

Undistributed collection represents the accumulated unidentified interbranch deposits made at SBC bank account which remains unidentified as at audit date. Proper applications of deposits are subsequently taken up in the books when identification and verification processes are duly satisfied.

17. EQUITY

The Corporation has an authorized capital stock of P10.0 billion divided into 80 million common shares and 20 million preferred shares both with a par value of ONE HUNDRED PESOS (P100.00) per share. Details of its existing capital structure are as follows:

17.1. Capital Structure

	2014	2013
Capital Stock		
Common shares		
National Government	**804,944,300**	804,944,300
Land Bank of the Philippines	**393,611,500**	393,611,500
Development Bank of the Philippines	**218,673,100**	218,673,100
Philippine National Bank	**40,000,000**	40,000,000
Social Security System (SSS)	**16,000,000**	16,000,000
Government Service Insurance System (GSIS)	**46,673,100**	46,673,100
	1,519,902,000	1,519,902,000
Preferred shares		
Social Security System	**200,000,000**	200,000,00
Government Service Insurance System	**200,000,000**	200,000,00

	2014	2013
	400,000,000	400,000,000
	1,919,902,000	1,919,902,000
Paid In Capital In Excess of Par	**79,510,460**	79,510,460
	1,999,412,460	1,999,412,460
Retained Earnings at end of year		
Appropriated retained earnings		
Guarantee Reserve Fund	**250,000,000**	250,000,000
Appropriated for dividend	**30,673,100**	30,673,100
	280,673,100	280,673,100
Fair value through profit or loss reserve	**242,824,008**	298,138,952
Unappropriated retained earnings	**27,035,959**	(175,591,956)
	550,533,067	403,220,096
	2,549,945,527	2,402,632,556

On December 13, 1993, the Board of Directors passed Board Resolution (BR) No. 102 which provided the terms and conditions of the preferred stock, to wit: (1) with a fixed annual dividend of eight per cent; (2) with participating rights as to dividends; (3) with voting rights; (4) convertible into common stocks within 10 years from date of issue at the option of the holder; (5) with redemption rights after the lapse of the 10 year period from date of issue at the option of the holder. The redemption price shall be based on the adjusted book value of the stock at the time of redemption.

On September 26, 2003, the Board of Directors passed and approved BR No. 1074 which superseded BR No. 102, series of 1993 and ratified during the 10th Annual Stockholders Meeting on January 29, 2005. The approved new features of the preferred stocks are as follows:

a. Preference in the payment of dividends in accordance with the principle of equity with common stockholders in the declaration and distribution of corporate dividends;

b. Preference in the claim against corporate asset in the event of dissolution or bankruptcy;

c. Each share of its outstanding preferred stocks is entitled to a vote during stockholders meeting;

d. Entitled to exercise its preemptive right to increase shareholdings through the equivalent unissued common shares;

e. Entitled to a Board seat in accordance with Section 11 and 3 of R. A. No. 6977 as amended by R. A. No. 8289; and

f. The appropriated portion of the retained earnings in the amount of P61,346,200 represents unissued shares corresponding to the cumulative dividends of the preferred shareholders (GSIS and SSS) representing its cumulative dividends from January 2002 to December 31, 2007. In 2013, the amount P30,673,100 in previously appropriated retained earnings was released to GSIS upon presentation of its certificate of acceptance.

17.2. Additional Paid in Capital

The account, which first appeared in SBC audited financial statements as at December 31, 2002, represented the 10 per cent excess of par for shares issued by the Corporation to the National Government for the Guarantee Fund for Small and Medium Enterprises (GFSME) assets turned over to SBC in response to Executive Order (EO) No. 28 dated July 30, 2001 which mandated the consolidation of GFSME and SBGFC with the latter as the surviving entity.

18. SCHEDULE OF ADMINISTRATIVE EXPENSES

	2014	2013
PERSONAL SERVICES		
Salaries and wages - basic	**55,694,636**	57,650,144
Bonus and other incentives	**21,825,047**	25,736,602
Provident Fund employer contribution	**8,020,126**	8,437,344
GSIS employer contribution	**6,698,801**	7,085,466
Other employee benefits	**5,943,819**	5,606,507
Representation and transportation allowance	**5,295,002**	5,788,500
Employee benefits - PERA/ACA	**3,252,645**	3,294,230
Board fees	**710,000**	550,000
HDMF employer contribution	**541,187**	559,650
PHILHEALTH employer contribution	**163,900**	166,600
Salaries and wages - overtime pay	**61,006**	86,962
	108,206,169	114,962,005
MAINTENANCE AND OTHER OPERATING EXPENSES		
Taxes and licenses	**11,058,793**	12,064,419
Security, janitorial and other contracted services	**8,777,427**	7,177,605
Depreciation	**7,261,148**	7,285,304
Extraordinary/miscellaneous expense	**5,135,500**	5,087,911
Communication services	**3,641,200**	3,581,912
Auditing services	**3,326,203**	3,259,169
Power, light and water	**2,986,716**	2,888,466
Development cost	**2,752,345**	3,022,058
Repairs and maintenance	**2,360,197**	1,989,397
Rental	**2,254,863**	2,066,341
Condominium dues	**2,144,044**	2,125,486
Travelling expenses	**2,132,387**	2,287,091
Supplies, materials and printing	**1,644,197**	1,896,593

	2014	2013
Insurance premiums	**1,596,573**	1,796,155
Training and seminars	**1,161,256**	969,861
Fuel, oil and lubricants	**937,473**	1,512,660
Business development expenses	**785,553**	605,856
Management and other professional fees	**713,792**	1,169,875
Board and committee expenses	**785,553**	631,639
Advertising and business promotion	**450,106**	1,123,835
Subscription and periodicals	**81,852**	91,732
Other	**10,169,980**	10,681,788
	72,045,820	73,315,153
	180,251,989	188,277,158

19. EMPLOYEE BENEFITS

19.1. Provident Fund

The fund is a defined contribution plan made by both the SBC and its officers and employees. The affairs and business of the fund are directed, managed and administered by its Board of Trustees. Upon retirement, death or resignation, the employee or his heirs will receive from the fund payments equivalent to his contributions, his proportionate share of the corporate contributions and investment earnings thereon.

The creation of the provident fund was authorized by the Board of Directors per BR No. 396, series of 1997 as amended by the Department of Budget and Management in its letter dated March 13, 2003.

19.2 Retirement Benefits

Retirement benefits are available to qualified employees under any one of the following laws:

Covering Law	Coverage	Available Benefits	Paying Institution
RA 1616	Employees as at 31 May 1977 with 20 years of service (YS), the last three years of which are continuous	One month basic salary (BS) for the first 20 YS, 1.5 BS in excess of 20 up to 30 YS and 2.0 BS in excess of 30 YS	SBC
RA 8291	At least 15 YS, if below age 60 upon retirement, benefit is payable at age 60	Monthly pension or cash payment	GSIS

19.2. Terminal Leave Benefits

This represents the cash value of the accumulated vacation and sick leave credits of employees, 50 per cent of which can be monetized.

20. LEASES

The Corporation leases the premises which served as SBC extension offices in Cebu, Davao, Baguio and other desk offices in the different regions of the country for a period of one year and have the option to renew such leases annually under certain terms and conditions.

21. INCOME TAX

The income tax was arrived at as follows:

REGULAR CORPORATE INCOME TAX (RCIT)			
Financial income			14,876,472
Add: Non-deductible Expenses/Taxable Other Income			
Interest Arbitrage Limitations:			
Investments	113,991,782		
Interest on bank deposits	212,834		
Gross Income subject to final tax	114,204,616		
Rate of reduction	33%	37,687,523	
Provision for probable losses		41,527,768	79,215,291
Total			94,091,763
Less: Non-taxable Income and Income Subjected to Final Tax			
Investments in gov't securities		91,193,426	
Interest on bank deposits		170,267	
Dividend income		463,484	91,827,177
Taxable Income			2,264,586
Application of Net Operating Loss Carry Over (NOLCO)			
CY 2011			1,936,345
CY 2013			328,241
			-
Tax Rate			30%
Income Tax Due			**-**

Minimum Corporate Income Tax (MCIT) Computation:

Income before Provision for Impairment Loss on Loans		212,456,403	
Add: Other Income		26,564,991	
Gross Income		239,021,394	
Less: Reconciling Items (income subjected to final tax)			
Investment in government securities	91,193,426		
Interest on bank deposits	170,267		
Dividend income	463,484	(91,827,177)	
Litigation expense		(208,971)	
Impairment loss-loans		(6,393)	
Foreclosure & acquired asset expenses		(2,149,799)	
Realized foreign exchange gain		(898,931)	
Interest arbitrage limitations		37,687,523	
Taxable Gross Income		181,617,646	
MCIT rate		2%	
MCIT due		**3,632,353**	a/
Less: Prior Year's Excess Credits Other Than MCIT	1,494,258		
QUARTERLY TAX CREDITS DURING THE TAXABLE YEAR			
1st quarter	1,102,334		
2nd quarter	535,684		
3rd quarter	592,375		
4th quarter	224,471	3,949,122	
TAX STILL DUE (Over payment)		**(316,769)**	

INCOME TAX BENEFIT COMPUTATION

1. DEFERRED TAX ASSET (DTA)-ALLOWANCE FOR DOUBTFUL ACCOUNTS (DA)

2014 Provision for probable losses	41,527,768	
Tax Rate	30%	
Income Tax benefit	**12,458,330**	b/
DTA - Allowances for Doubtful Accounts (DA) Beginning Balance	3,643,103	
Add: DTA-Allowance for DA for 2014	12,458,330	
DTA - Allowances for Doubtful Accounts (DA) End	16,101,433	

2. DEFERRED TAX ASSET (DTA)-TIMING DIFFERENCE COMPUTATION

Comprehensive Income		
Unrealized gain/(loss) in foreign currency translation	168,524,396	
Unrealized gain/(loss) on derivative valuation	(53,438,084)	
Net	115,086,312	
Tax Rate	30%	
DTA - Timing Difference as of 12/31/14	34,525,894	
DTA - Timing Difference Beginning Balance	23,949,142	
Income Tax benefit	**10,576,752**	c/

Minimum Corporate Income Tax							
Year Occurred	Normal Income Tax	MCIT	Excess MCIT over Normal Income Tax	Balance MCIT still allowable tax credit	Available until	Expired/Used portion of excess MCIT	Excess MCIT applied this current year
2014	-	3,632,353		3,632,353	2017		
2013	-	3,477,314	-	3,477,314	2016		
2012	-	4,570,968		4,570,968	2015		
2011	-	5,005,519			2014	5,005,519	
Total	-	16,686,154		11,680,635		5,005,519	d/

Net Operating Loss		Net Operating Loss Carry Over				
Year Occurred	Amount	Applied Previous Year	Applied Current Year (2012)	Available until	Expired	Balance
2013	131,200,395		(328,241)	2016	-	130,872,154
2011	1,936,345		(1,936,345)	2014	-	-
Total	133,136,740		(2,264,586)			130,872,154
Tax Rate	30%		30%			30%
DTA	39,941,022		(679,376) e/		-	39,261,646

INCOME TAX BENEFIT

a/ MCIT	3,632,353
b/ Allowance for doubtful accounts	12,458,330
c/ Timing Difference	10,576,752
d/ Expired MCIT	(5,005,519)
e/ Applied NOLCO	(679,376)
Total	**20,982,540**

22. RESTATEMENT

Statement of Cash Flows in the 2013 Annual Audit Report (AAR) was restated to reflect proper amounts of reported unapplied collections, to conform with the 2014 presentation.

Accounts reflected are as follows:

	Restated	**Reported**	**Net effect**
Cash Flows from Operating Activities:	2013	2013	
Cash Inflows:			
Collection of Loans	3,082,083,334	2,997,291,459	84,791,875
Payment received lodged in "Undistributed Collections"	980,333	85,772,208	(84,791,875)
Sub-total	3,083,063,667	3,083,063,667	-

Cash Flows from Operating Activities:	Restated 2013	Reported 2013	Net effect
Cash Outflows:			
Loans Granted	2,929,467,321	2,866,585,261	62,882,060
Application of payment for "Undistributed Collection"	-	62,882,060	(62,882,060)
Sub-total	2,929,467,321	2,929,467,321	-
Net effect on Cash Provided by Operating Activities	153,596,346	153,596,346	-

23. CONTINGENT LIABILITY

Under the guarantee agreement executed by and between SBC and its accredited financial institutions (AFIs), the former guarantees to the latter the payment to the extent of 85 per cent of the loan balance outstanding, including unpaid interest for one repayment period, of loans extended to small and medium enterprises in case of non-repayment by the AFI's borrower in consideration for a two per cent guarantee fee of the outstanding guarantee of the loan. As at December 31, 2014 and 2013, the Corporation's outstanding guarantees amounted to P209,257,550 and P136,230,143, respectively.

On May 26, 2006, the Board of Directors passed and approved Board Resolution No. 1319, series of 2006 for the setting aside of the amount of P250 million as Guarantee Reserve Fund to back up the Corporation's guarantee commitments on a 3:1 leverage ratio. The said fund was formally established in December 2007 consisting of treasury bills with various maturity dates and interest rates. The fund will be used solely to back-up calls on SBC guarantee issued to AFIs.

24. 2014 STATEMENT OF COMPREHENSIVE INCOME DISCLOSURE

For the purpose of determining the profitability of SBC per Governance Commission for GOCCs (GCG) Memorandum Circular No. 2012-11 (re-Issued). The Corporation reported a net income before tax for the fiscal year 2014 at P32.227 million. The amount, as similarly presented in SBC previous audited Statement of Comprehensive Income, is before other comprehensive income or loss as a result of the Corporation's adoption of Philippine Accounting Standards Nos. 1 and 39 (Presentation of Financial Statements and Financial Instruments: Recognition and Measurement, respectively) which consider the Corporation's foreign exchange risk cover arrangement with the Department of Finance as a derivative instrument. Comprehensive income/(loss), in particular in SBC's operations, are technically unrealized income or loss resulting from changes in between reporting periods of foreign currency valuation of the Company's liabilities denominated in foreign currency and changes in derivative valuation as a result of changes in underlying used in computing for its financial value through the application of an acceptable valuation model (Black-Scholes Option Model).

Those comprehensive income or loss are regarded merely as a "paper income or loss as they do not represent actual result of current operation". Its separate presentation in the financial *statement allows users to more easily identify the potential impact that other comprehensive income items may have in future profit or loss" (ERNST & YOUNG – changes to the presentation of other comprehensive income amendments to IAS 1)*

In relation thereto, the Philippine Securities and Exchange Commission in its memorandum Circular No. 11, series of 2008 entitled "Guidelines on the determination of retained earning available for dividend declaration" specifically identify the following as items not available for dividend declaration:

a. unrealized foreign exchange gain, and
b. fair value adjustments arising from marked-to-market valuation which are not yet realized.

Such identification was formulated to segregate those actual income or surplus items arising from the operation of the corporate business form those income still subject to future realizations as only the bonafide surplus profits or income founded upon <u>actual earnings</u> can be declared for dividend whether cash, property or stock.

25. RELATED PARTY TRANSACTIONS

Section 10 of RA 9178, otherwise known as the "Barangay Micro Business Enterprises (BMBE) Act of 2002" had set up an endowment fund of P300 million from the Philippine Amusement and Gaming Corporation (PAGCOR) and to be administered by the Small and Medium Enterprise Development (SMED) Council and now Micro, Small and Medium Enterprises (MSMED), an inter-agency body attached to the DTI. The MSMED Council designated SBC, as the Fund Manager of the BMBE Development Fund per Memorandum of Agreement dated December 28, 2004. Total remittance of P300,000,000 to SBC was invested in government securities and earned interest income of P112,820,523 as at December 31, 2014. A total of P10,477,465 was disbursed to the different beneficiaries identified by the MSMED Council covering the period 2004-2011. Upon advice of BSP as affirmed by the Commission on Audit that the BMBE account is a trust account that should not be reported in the SBC's books, the Corporation took off from its records said account and set up a separate books of accounts for the BMBE Development Funds effective December 31, 2012.

As at December 31, 2014, the BMBE Development Fund showed a Fund balance of P413,018,793.

26. ENTERPRISE REHABILITATION PROGRAM

The account represents the P100 million fund received from the National Government to support the corporation's Enterprise Rehabilitation Program, a special credit facility for the rehabilitation of micro and small enterprises located in hardly hit calamity areas like those devastated by "Typhoon Yolanda". This financial assistance is aimed to leverage the said P100 million fund by four times to be funded by the Corporation's internally generated funds. As of December 31, 2014 amount released to ERF borrowers amounted to P250.9 million (see Note 8). The fund balance of P3.2 million is lodged to a special credit account to support subsequent loan releases under the said program.

27. COMPLIANCE WITH REVENUE REGULATIONS

Tax Compliance

In compliance with the requirements set forth by Revenue Regulations (RR) No. 15-2010, hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year 2014.

The taxes and licenses paid/accrued during the year are as follows:

Withholding Taxes

	2014	2013
Taxes on compensation and benefits	**14,234,289**	14,756,301
Value added taxes (VAT)	**2,164,710**	2,563,679
Expanded withholding taxes (EWT)	**1,448,191**	1,216,738
Gross Receipt Taxes	**10,730,130**	11,689,739
	28,577,320	30,226,457

These taxes, except for taxes on compensation and benefits, were remitted in the SBC's capacity as withholding agent pursuant to RR No. 17-2003 as amended by RR No. 14-2008, with SBC having been determined as one of the top 20,000 corporations and as such, was designated as a withholding agent by the BIR.

Other taxes

	2014	2013
Local		
Real estate taxes	**1,316,475**	982,299
Corporate community tax	**10,500**	10,500
National		
Capital gains taxes	**1,759,560**	3,673,622
Documentary stamp taxes	**17,270,499**	20,695,669
Transfer taxes	**168,599**	338,828
BIR annual registration	**500**	500
	20,526,133	25,701,418

Part II

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATIONS AND RECOMMENDATIONS

1. Personnel services and employees benefits totaling to P30.778 million were not approved by the Office of the President (OP) and are in excess of the Department of Budget and Management (DBM) approved Corporate Operating Budget (COB), contrary to Section 10 of Republic Act (RA) No. 10149 and the pertinent provisions of Presidential Decree (PD) Nos. 1597 and 1445, thus, without legal basis.

1.1 Section 10 of RA No. 10149 or known as "GOCC Governance Act of 2011" states:

> *"Additional Incentives. The GCG may recommend to the President incentives for certain position titles in consideration of the performance of the GOCC"*.

1.2 Section 5 of PD No. 1597 dated June 11, 1978 states:

> *Allowances, Honoraria, and Other Fringe Benefits. Allowances, honoraria and other fringe benefits which may be granted to government employees, whether payable by their respective offices or by other agencies of government, shall be subject to the approval of the President upon recommendation of the Commissioner of the Budget. For this purpose, the Budget Commission shall review on a continuing basis and shall prepare, for the consideration and approval of the President, policies and levels of allowances and other fringe benefits applicable to government personnel, including honoraria or other forms of compensation for participation in projects which are authorized to pay additional compensation.*

1.3 PD No. 1445, under Sections 61 and 103, provides:

> *Section 61. Audit of expense accounts. The examination of expense accounts shall be undertaken to ascertain that all expenses incurred have been duly authorized; adequately funded and documented; properly recorded; all recorded expenses have been actually incurred; and the classifications of expenses are appropriate and have been consistently followed.*
>
> *Section 103. General liability for unlawful expenditures. Expenditures of government funds or uses of government property in violation of law or regulations shall be a personal liability of the official or employee found to be directly responsible therefor.*

1.4 COA Circular No. 2013-003 dated January 30, 2013:

> *Paragraph V. Audit Action by the COA Auditor. All COA Auditors are directed to disallow in audit all payments of allowances, incentives and other fringe benefits to all government officials and employees which have*

no legal basis and do not conform strictly with the laws, rules and regulations authorizing such payments.

1.5 Payment for Personnel Services amounting to P9,337,753 were paid without legal basis and/or in excess of the DBM approved COB. Comparison of the approved COB of SBC for Personnel Services with the actual expenses showed the following variance/excess over approved COB:

Personnel Services (PS)	Approved COB	Actual Expenses	Excess over Approved COB	Remarks
Salaries, wages and bonuses, regular	46,585,000	54,015,764	7,430,764	Excess salary provisions for 151 positions; no legal basis.
PERA/Additional Compensation	1,760,000	3,251,554	1,491,554	Additional of P1,000 not extended to SSL exempt GOCC per AO 144.
Productivity incentive bonus (PIB)	302,376	650,000	347,624	Excess provisions over the authorized P2,000/ employee.
Leave encashment/ terminal	1,476,000	1,507,623	31,623	Excess payment over approved COB
Philhealth Contribution	505,000	541,188	36,188	Computed using rates under Philhealth No. 01 s. 2005.
Total	**50,628,376**	**59,966,129**	**9,337,753**	

1.6 Moreover, the COB of SBC for employees benefits for CY 2014 as approved by the DBM dated October 9, 2014 on the following benefits amounted to P1,127,000. Comparison of the actual expenses for employees benefits with the approved COB, however, showed a difference of P14,613,240 representing the expended amount without OP approval, as follows:

Employees Benefits	Proposed 2014 Budget	Approved COB	Variance	2014 Actual Expenses	No OP Approval
Meals	924,000	-	924,000	881,480	881,480
Children	55,000	-	55,000	49,080	49,080
Rice subsidy	3,360,000	-	3,360,000	3,258,865	3,258,865
Medical	1,096,000	-	1,096,000	1,014,873	1,014,873
Financial assistance	7,016,500	563,500	6,453,000	5,306,564	4,743,064
Economic assistance	7,016,500	563,500	6,453,000	5,229,378	4,665,878
Total	**19,468,000**	**1,127,000**	**18,341,000**	**15,740,240**	**14,613,240**

1.7 In addition, payment of the following benefits were paid without OP approval:

a. Payment to SBC regular employees and all non-organic personnel for year-end gift check and token of appreciation totaling P6,681,209; and

b. Payment of the group life insurance to SBC employees and members of the Board of Directors in the amount of P146,246.

1.8 The Governance Commission for Government Owned or Controlled Corporations (GCG), as a matter of policy, evaluates compensation matters on a total pay package. DBM examines the individual items in the compensation package as in

SBC's COB for CY 2014. The said total pay package form part of the Compensation and Position Classification System (CPCS) mandated by the GOCC Governance Act of 2011 (RA No. 10149) for submission to the Office of the President for approval. SBC's CPCS is not yet approved by the President.

1.9 In summary, the total personnel services and employees benefits without OP approval and in excess of the DBM approved COB are as follows:

a. Personnel services	P	9,337,753
b. Employee benefits		14,613,240
c. Gift checks and token of appreciation		6,681,209
d. Group life insurance		146,246
Total	**P**	**30,778,448**

1.10 We recommended that Management:

a. Seek OP approval, through the DBM, of the personnel services and employees benefits expenses as required under Section 10 of RA 10149 and pertinent provisions of PD Nos. 1597 and 1445;

b. Submit the latest status of the CPCS for approval of the President; and

c. Henceforth, suspend and/or discontinue the grant of the subject benefits.

1.11 Management commented the following:

a. Management replied on payment of personnel services and employees benefits that they referred the matter to the GCG. They believe that the issue at hand can be resolved only by external parties whose governing powers over them are beyond the realm of their capability to influence. Hence, they can trust in COA's benevolence in the fair treatment of this matter for the good of the government and its loyal SBC Officers and employees.

b. With regard to the payment of gift checks and token of appreciation, the legal basis is found in Section 11 (f) of RA 9501 passed on 23 May 2008 which states:

> *(f.) Notwithstanding the provisions of Republic Act No. 6758 and Compensation Circular No. 10, series of 1989 issued by the DBM, the Board shall have the authority for the organizational structure and staffing pattern of SBC and to exert to the employees and personnel salaries, allowances and fringe benefits similar to those extended to and currently enjoyed by employees and personnel of other government financial institutions.*

b.1 The above provision in fact is merely a restatement of a similar provision found in RA No. 8289, the earlier amendatory law of SBC's Charter, RA No. 6977.

b.2 The SBC Charter and the amendatory laws, specifically RA Nos. 8289 and 9501 were passed by Congress and approved by the President of the Philippines much later than PD No. 1597 which was promulgated by then President Ferdinand E. Marcos on 11 June 1978 pursuant to his Martial Law powers. We believe therefore that RA No. 6977 and its amendments had in effect modified Section 5 of PD No. 1597, insofar as the SBC is concerned. Please note that the laws governing the SBC Board of Directors' power to extend to the SBC employees and personnel salaries, allowances and fringe benefits similar to those of other government financial institutions (GFI's), did not require prior approval of the Office of the President. It is basic rule in statutory construction that where the provisions of two laws are in conflict, the provision of the later law shall prevail. RA No. 9501 restates this basic principle in its Section 23 which states:

> *Section 23. Repealing Clause. – All laws, executive orders, rules and regulations, or parts thereof, inconsistent herewith are hereby repealed and modified accordingly.*

b.3 Moreover, it is a basic principle that in case of a conflict between provisions of a general law and specific law, the provisions of the later part shall prevail. PD No. 1597 is a law of general application while the SBC Charter applies only a specific institution.

b.4 The only condition required for the exercise by the SBC's power to grant the subject salaries, allowance and fringe benefits is that these must be enjoyed by the employees and personnel of other government financial institutions. The SBC has more than complied with this condition. They respectfully take exception to the categorization of these benefits as excessive, extravagant, or unconscionable. They have commissioned a third party consultancy firm, Center for Public Resource Management, Inc. (CPRM), to conduct a compensation survey of six GFI's namely LBP, SSS, GSIS, DBP, PDIC, and Philexim. Based on the survey results and the recommendations of the CPRM, Board of Directors developed a reasonable compensation package which was in fact approved by the Secretary of the Department of Trade and Industry (DTI). This was the legal basis for the continued grant of the SBC's package of benefits, including the subject gift checks. These are similar to, and in many instances, even lower than those enjoyed by employees and personnel of other GFIs. In fact, the DBM has consistently allowed the payment of subject benefits, impliedly recognizing the legal basis thereof.

c. Group Accident/Life Insurance for SBC officials and employees was approved under Board Resolution No. 1100, series of 2003. It finds legal basis in Section 8 of RA No. 8289 which provides:

“(e) Notwithstanding the provisions of Republic Act No. 6758, and Compensation Circular No. 10, series of 1989 issued by the Department of Budget and Management, the Board of Directors of SBC shall have the authority to extend to the employees and personnel thereof the allowance and fringe benefits similar to those extended to and currently enjoyed by the employees and personnel of other government financial institutions.”

c.1 A comparative survey conducted in 2003 of other GFIs which provided similar benefit (DBP, PNB, GSIS and PDIC) was presented to the Board.

c.2 This is one of the employee welfare programs that is much appreciated by our employees because of fast and immediate extension of economic relief to the heirs and dependents of deceased employees, as contrasted to slow processing of parallel GSIS claims. In the 12 years that they have covered their employees (2003 to 2015), they were able to claim a total of P2.5 million life insurance for three deceased employees; and

c.3 Furthermore, this employee welfare program is also part of the package that was disclosed to GCG and its consulting firm Towers Watson in 2013, in the course of the latter’s survey for purposes of drafting a CPCS for GOCCs as mandated under RA 10149.

1.12 As a rejoinder, we believe that the subject allowances and benefits need OP approval as required under RA No. 10149, PD Nos. 1597 and 1445. The power granted by the SBC Charter to the Board of Directors is not absolute because they are limited by the specific provisions of laws as discussed in Paragraphs 1.1 to 1.3 above.

2. Six acquired assets with total market value of P27.346 million are either occupied by informal settlers or previous owners, hampering immediate disposal and significantly reducing its value and marketability. Moreover, two items of chattels with total appraised value of P1.164 million are still in the possession of the previous owners, exposing them to risk of loss contrary to the SBC policies and guidelines on Management of Acquired Assets (AA) under SBC Board Resolution No. 466, series of 1998.

2.1 SBC policies and guidelines on Management of Acquired Assets (AA) under SBC Board Resolution No. 466, series of 1998 states:

Section V-A – Administration of AA (Custody and Security)
xxx. Immediately after delivery or turnover of the assets by the Sheriff to SBGFC, the AAU shall take steps to secure the properties. In order to prevent trespassing, squatting and other forms of illegal occupancy of acquired real estate properties or safeguard the assets from pilferage, theft, or vandalism, the following preventive measures shall be undertaken:

1. xxx

2. The AAU shall determine and recommend the necessity of hiring and choosing a duly accredited security agency for the security of the properties. The selection of the agency shall, however, be in accordance with the COA rules and regulations. The AAU shall henceforth, assume responsibility for the safekeeping, protection and preservation of the properties and shall from time to time, report to management the general condition of the properties and submit any proposal, which, in its opinion, is necessary to protect and preserve the same. Xxx.

2.2 SBC, however, did comply with the above provisions. Inspection/review of the AA with a total appraised value of P27,346,320 and chattels with total appraised value of P1,163,781 disclosed the following deficiencies:

Particulars/Deficiencies	Location	TCT No.	Area in sqm	Date Appraised	Market Value
a. The property is occupied by an auto repair shop and a few residential structures with informal settlers. the disposal of the property had been hampered by an annotation of Lis Pendens at the back of the TCT since 1991 and the presence of informal settlers. The loan was approved for guarantee by then Guarantee Fund for Small and Medium Enterprises (GFSME) on Feb. 26, 1986 and was released by a bank on June 26, 1986. The loan was eventually taken out on September 11, 1986 by then GFSME.	Bolton St., Davao City	TCT No. 158509	8,548	03/02/2010	18,545,000
b. The lot in is entirely occupied by informal settlers. Some settler structures that were built on the property are very old and seemed that they had been there for a long time. Verification revealed that the property already had occupants even before it was acquired and turned-over to the Administrative Services Group (ASG) of SBC.	General Santos City	TCT No. 103131	2,737	10/22/2012	2,737,000
c. The remaining unsold lot is occupied by an owner of an auto repair shop.		TCT No. 8215	5,165	06/01/2012	2,801,120
d. The lot with residential house is still being occupied by the previous owners. The lot across the street is occupied by the couple's immediate family members. The buyer of the latter property backed out because there had been no proper turn-over of physical possession of the property and because of the Notice of Levy and Adverse Claim on the Title and Tax Declaration, filed by the couple.	Mandaue City, Cebu	TCT No. 59490 TCT No. 60340	160 158	06/28/2010	711,000
e. The is still being occupied by the previous owners. At the time of visit, we were attended to at the gate by a care-taker and were not allowed to enter the premises. Allegedly, the previous owners were not around but she had to enter the house first before talking to us.	Bacolod City	TCT No. 83214	387	11/06/2012	1,269,000

Particulars/Deficiencies	Location	TCT No.	Area in sqm	Date Appraised	Market Value
f. The property located is still occupied by a relative of the borrower/mortgagor. Verification revealed that a Notice of Lis Pendens had been annotated at the back of the TCT filed by the occupant. It is noteworthy that the Lis Pendens was filed on 29 September 1995, much earlier than the grant of the loan and guaranty by a bank and SBC, respectively, on 10 December 2002.	San Jose, Antique, Barangay Atabay, San Jose, Antique	TCT No. T-27878 (new) T-18023 (old)	1,604	06/10/2010	1,283,200
Sub-total acquired assets					**27,346,320**
g. Various acquired machines of a Multi-Purpose Cooperative are still being used by the Cooperative free of rent, not to mention the exposure of the chattels to risk of loss.	Bacolod City	Chattel		04/04/2009	583,481
h. The chattels (printing equipment, etc.) stored at the place of the borrower is exposed to the risk of physical loss and decline in value while these remain undisposed.	Davao City	Chattel		02/04/2009	580,300
Sub-total for Chattel					**1,163,781**
Total					**28,510,101**

2.3 We recommended that Management:

a. Strictly adhere to SBC policies and guidelines on acquired assets.

b. Pursue aggressive legal action in asserting the rights of SBC over the acquired assets; and

c. Conduct regular monitoring of the conditions of acquired assets.

2.4 Management commented the following:

a. The four real and other properties acquired (ROPA) accounts have pending cases which unfortunately remain unresolved to date. The former owners occupy the property since they are basically questioning the foreclosure of their property. The matter is being attended/handled by the SBC Legal Services Group (LSG) and ASG is closely coordinating with the Group with whatever assistance it can provide to expedite the resolution of the cases.

b. The long standing Nullity of Foreclosure Sale filed by the former owners has been resolved by the RTC-Davao City Branch 11 in the favor of SBC. However, the heirs have appealed the decision of the lower court with the Court of Appeals (CA). According to LSG, other than preparing for the next legal battle in the CA, a Writ of Possession was filed against the occupants of the property.

c. ASG will coordinate with Mindanao Group (MG) and LSG for the legal action to remove the illegal occupants in the property.

d. There are presently fixed offers for the TCT No. 8215, the remaining property acquired from the former owners. Meantime, ASG requested the re-appraisal of the property to update the property's value. Thereafter, ASG shall present its recommendation to the Acquired Asset Management Committee.

e. It should be noted that there are two other properties acquired from this account which was sold to a single buyer last year. The buyer is fully aware of the legal impediment on the titles since this was disclosed to him notwithstanding the as-is-where-is clause. Part of the condition of the sale is that the buyer will work for the cancellation of the impediment on the Title at his own expense.

f. ASG has been negotiating with the former owners for the buy back of the chattel properties while there are no interested buyers of the chattels. Presently, our Mindanao and Visayas Groups do not have the facilities to house the chattels. ASG will have to charge rent for the use of the chattels by the former owners.

2.5 As a rejoinder, Management comments are duly noted, however, we still recommend that Management continuously pursue aggressive legal action against illegal occupants of SBC ROPA.

3. Five acquired assets with an aggregate book value of P8.526 million and total appraised value of P25.665 million were not disposed of within the prescribed period of five years, contrary to the provisions of the General Banking Act of 2000, depriving SBC the opportunity to generate necessary funds to sustain its operations.

3.1 Section 52 of Republic Act (RA) No. 8791 dated 23 May 2000, also known as the General Banking Act of 2000, requires that:

> *"Any Real Property acquired or held shall be disposed of by the bank within a period of five (5) years or as may be prescribed by the Monetary Board."*

3.2 Contrary thereto, five acquired assets with total book value of P8,526,249 and total appraised value of P25,665,320 with Real Estate Mortgage (REM) previously guaranteed by the Guarantee Fund for Small and Medium Enterprises (GFSME) were not disposed of within five years from the date of consolidation ranging from 5.75 to 23 years as follows:

Asset Description (TCT No. and AREA)	Book Value	Consolidated Date	No. of yrs undisposed 12/31/2014	Appraised Value	Appraisal Date
TCT No. 158509; 8,548 sqm.	2,692,867	08/14/91	23.00	18,545,000	03/02/10
TCT No. 103131; 2,737 sqm.	2,052,750	06/17/04	10.50	2,737,000	10/22/12
TCT No.82215; 5,165 sqm.	2,027,468	10/01/02	12.75	2,801,120	06/01/12

Asset Description (TCT No. and AREA)	Book Value	Consolidated Date	No. of yrs undisposed 12/31/2014	Appraised Value	Appraisal Date
TCT No. 60340: 158 sqm.	1,499,207	03/12/09	5.75	711,000	6/28/10
TCT No. 59490: 160 sqm.				736,000	6/28/10
TCT No. 218048; 338 sqm.	253,957	07/18/02	12.50	135,200	11/07/12
Total	**8,526,249**			**25,665,320**	

3.3 We recommended that Management:

a. Comply strictly with the provisions of the General Banking Act of 2000 on the disposal of acquired assets within five years, and

b. Initiate immediate disposal of the subject acquired assets.

3.4 Management commented the following:

From the time the Titles to the properties were consolidated in the name of SBC, efforts have been made to promote and create awareness that these properties are available for sale. Presented below is the disposal history of each property indicating the date of publication in newspapers of national circulation (Phil. Inquirer/ Phil. Star) when these were first offered for sale through public bidding and the succeeding times these were on negotiated sale basis:

ROPA Acct/ Title No.	Disposal History	
	Disposal	Date
TCT No. 158509	Public Bidding	12-19-2006
	Negotiated Sale	06-15-2010
TCT No. 103131	Public Bidding	12-19-2006
	Negotiated Sale	04-25-2007
	Negotiated Sale	09-13-2012
	Negotiated Sale	04-11-2013
	Negotiated Sale	08-08-2013
TCT No. 82215	Negotiated Sale	07-21-2008
	Negotiated Sale	11-21-2011
TCT No. 59490	Public Bidding	06-19-2008
TCT No. 60340	Public Bidding	05-14-2009
	Negotiated Sale	10-24-2013
	Negotiated Sale	01-30-2014
TCT No. 218048	Public Bidding	10-25-2006
	Negotiated Sale	06-19-2008
	Negotiated Sale	06-02-2011
	Negotiated Sale	04-11-2013

Other than the publication of these properties over the years, the properties were, likewise included in the first SBC Properties for Sale magazine which came out in September 2013.

On the local level, “For Sale” signages are posted on the property.

4. The appraisals of five acquired assets with the last total appraised value of P21.572 million are not updated contrary to BSP Circular No. 520, series of 2006.

4.1 BSP Circular No. 494, series of 2005, amended by BSP Circular No. 520, series of 2006 particularly Section 3(c) states that:

"5. Appraisal of Properties. Before foreclosure or acquiring any property in settlement of loans, it must be properly appraised to determine its true economic value. If the amount of ROPA to be booked exceeds P5 million, the appraisal must be conducted by an independent appraiser acceptable to the BSP. An in-house appraisal of all ROPAs shall be made at least every other year: Provided, That immediate re-appraisal shall be conducted on ROPAs which materially decline in value."

4.2 We noted that contrary to the above provisions, the appraisal reports on the following five acquired assets from four borrowers are not updated:

Property Location	Asset Description	Last Appraised Value	Last Appraisal Date	No. of Yrs. not appraised
1. Davao City	TCT No. 158509; 8,548 sqm.	18,545,000	03/02/10	4
2. Cebu City	TCT No. 60340; 150 sqm.	711,000	06/28/10	4
3. Cebu City	TCT N0. 59490; 160 sqm.	736,000	06/28/10	4
4. Cagayan de Oro City	TCT No. 74861;400 sqm.	1,000,000	04/15/09	5
5. Davao City	Chattel Mortgage on various Machinery	580,300	02/04/09	5
	Total	**21,572,300**		

4.3 We recommended that Management comply strictly with the BSP guidelines on the appraisal of acquired assets.

4.4 Management commented that for the real and other properties acquired (ROPA) accounts, there were re-appraisals and updating done in 2011 and 2012. However, the latest values and appraisal dates were not reflected in the inventory reports while copies of the latest Appraisal Reports were not provided in the respective asset folders. Notwithstanding the re-appraisals done, updating shall be requested for this year.

4.5 As a rejoinder, re-appraisal submitted by Management are still not updated hence, we reiterated our recommendation that Management submit the updated appraisal reports of the subject property.

5. BMBE Development Fund amounting to P413 million, held in trust by SBC, was not utilized for more than three years (CYs 2012 to 2014) defeating the purpose for which the Fund was created.

5.1 Executive Order No. 431, series of 2005 requires government agencies to revert all dormant accounts, unnecessary special and trust funds to the General Fund and for other purposes.

5.2 Republic Act (RA) No. 9178 approved on November 13, 2002, an act to promote the establishment of Barangay Micro Business Enterprises (BMBE), providing incentives and benefits therefore, and for other purposes.

Sec. 2. Declaration of Policy.- It is hereby declared to be the policy of the State to hasten the country's economic development by encouraging the formation and growth of barangay micro business enterprises which effectively serve as seedbeds of Filipino entrepreneurial talents, and integrating those in the informal sector with the mainstream economy, through the rationalization of bureaucratic restrictions, the active intervention of the government specially in the local level, and the granting of incentives and benefits to generate much-needed employment and alleviated poverty.

Sec. 10. Technology Transfer, Production and Management Training, and Marketing Assistance.—A BMBE Development Fund shall be set up with an endowment of Three Hundred Million Pesos (P300,000,0000.00) from the Philippine Amusement and Gaming Corporation (PAGCOR) and shall be administered by the SMED Council.
The Department of Trade and Industry (DTI), the Department of Science and Technology (DOST), the University of the Philippines Institute for Small Scale Industries (UP ISSI), Cooperative Development Authority (CDA), Technical Education and Skills Development Authority (TESDA), and Technology and Livelihood Resource Center (TLRC) may avail of the said Fund for technology transfer, production and management training and marketing assistance to BMBEs.

5.3 A Memorandum of Agreement (MOA) was signed on December 28, 2004 by the Small and Medium Enterprise Development (SMED) Council, now Micro, Small and Medium Enterprise Development (MSMED) Council, represented by the Department of Trade and Industry (DTI) Secretary and Chairman of the MSMED Council; and Small Business Guarantee and Finance Corporation (SBGFC), now SBC, represented by its Chairman and CEO, provide among others, that the parties hereto agree and bind themselves as follows:

DUTIES AND RESPONSIBILITIES OF THE SMED COUNCIL

1. Administer the Three Hundred Million Pesos (Php300,000,000) endowment fund from PAGCOR and effect the transfer of said fund from the SMED Council to SBGFC.

2. Issue the implementing guidelines and promulgate such other rules as may be necessary for the effective and proper administration of the BMBE Development Fund.

3. Approve project proposals and request for funding under the BMBE Fund.

4. Prepare annual accomplishment reports that will be submitted to Congress and the Office of the President concerning utilization of the Fund.

DUTIES AND RESPONSIBILITIES OF SBGFC

As the Fund Manager of the BMBE Development Fund, SBGFC shall be responsible for the following:

1. Place the fund in interest-earning government securities.

2. Ensure proper disbursement and accounting of the BMBE Development Fund.

3. Process and release approved grant amounts to beneficiary agencies.

4. *Submit to the SMED Council semi-annual reports on the utilization and status of the fund, duly signed by the Chair SBGFC and verified by the COA Resident Auditor.*

5.4 As provided in the above MOA, SBC, as the fund manager of the Fund, has two main functions: a) to invest the Fund in interest-bearing government securities; and b) process/release disbursements upon instruction by the Council to beneficiary agencies as well as the proper accounting and maintenance of the Fund.

5.5 As of December 31, 2014, the Fund has the following account balances:

Accounts	December 31, 2014	
	Debit	Credit
Cash in Bank	P 850,945	
Cash n Bank – HYSA/SDA	43,000,000	
Investment in Government Securities (GS	361,863,698	
Interest Receivable in GS	4,039,081	
Interest Receivable investment-HYSA/SDA	8,000	
Due from SBC	3,257,069	
Due to SBC		P 198,270
BMBE Fund		412,820,523
	P 413,018,793	P 413,018,793

5.6 As shown in the above data, 98% of the Fund is invested in High Yield Savings Account (HYSA), Special Deposit Account (SDA) and interest-bearing government securities. The Fund earned a net income totaling P15,418,436 in 2014. For managing the Fund, SBC earned a Management Fee of P1,969,328 in 2014.

5.7 The BMBE Development Fund is an endowment fund, thus, only interest earnings of the Fund is utilized to finance technical assistance projects for micro enterprises. Net earnings of the Fund since 2005 up to 2014 totaled to P112,820,523.

5.8 Total availments of the Fund by implementing agencies as approved by the Council from 2006 to 2011 totaled only to P10,488,515 for 20 projects equivalent to less than three per cent only of the total BMBE funds.

5.9 For CYs 2012 to 2014 or for a period of three years, there were no utilization of the Fund, thus, defeating the purpose for which the Fund was created.

5.10 On November 5, 2014, SBC Management referred our audit observations to the Officer-in-Charge (OIC) of the Bureau of the MSMED, DTI for his written reply.

5.11 We reiterated our prior year's recommendation that Management, as part of the MSMED Council, to accelerate the utilization of the BMBE Fund to generate much needed employment and alleviate the informal sectors from poverty, otherwise, revert the Fund, now dormant, to the General Fund of the Government in accordance with Executive Order No. 431, series of 2005.

5.12 SBC Management commented that their responsibility for the said BMBE Fund is purely administrative in nature i.e. fund management, disbursement, accounting and reporting. The utilization of BMBE Development Fund, however, rests with MSMED Council who was mandated by law to be the catalyzer of the country's economic development of BMBE. As holder of said Fund, it is but natural that they refrain from deciding on the use of this Fund to maintain prudential control over the same.

Rest assured, however that they will refer again the concern to MSMED Council for their comments/appropriate action.

5.13 Mr. Jerry T. Clasevillas, OIC of the Bureau of Small and Medium Enterprises Development (BSMED) commented the following:

a. The utilization of the BMBE Fund is guided by the provisions of DTI-Department Administrative Order (DAO) No. 02-06. It has been noted however, that according to the assessment of the Technical Working Group (TWG) that was tasked to evaluate the project proposals, most of the proposals submitted for funding in 2012 and 2013 failed to meet the qualifications and requirements called for under the aforesaid DTI-DAO. Hence, said proposals failed to obtain the TWG's favorable endorsement and which explains in part the low utilization of the BMBE Fund.

It may be noted that there is an on-going effort of the MSMED Council to amend the fund utilization guidelines which we expect, will allow more SMEs to access the Fund.

b. The recently passed legislation, RA No. 10644 or the "Go Negosyo Act" provides for the following:

> *SEC. 7. Start-up Funds for MSMEs. – Aside from the existing benefits for MSMEs, the MSMED Council, through the DTI, the Department of Finance (DOF) and the appropriate financing institutions, shall establish a Start-up Fund for MSMEs to be sourced from the MSME Development Fund and BMBE Fund to provide financing for the development and promotion of MSMEs in priority sectors of the economy as specified in the MSMED Plan.*

c. It is expected that, pursuant to the foregoing provision, utilization of the BMBE Fund will accelerate once the guidelines on using the BMBE Fund as Start-up Fund for MSMEs is issued by the MSMED Council.

5.14 As a rejoinder, we noted Management comments, however, we stand by our recommendations to aggressively accelerate the utilization of the BMBE Fund otherwise, revert the Fund to the General Fund of the Government.

6. Undistributed Collections amounting to P1.375 million for the past five years were reclassified to Miscellaneous Income account resulting in the overstatement of both Loans Receivables and Miscellaneous Income accounts.

6.1 Paragraph 3 of PAS No. 1 - Presentation of Financial Statements states that:
.

> *Financial statements shall present fairly the financial position, financial performance and cash flow of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. xxx..*

6.2 Undistributed Collections represents actual cash collections from borrowers which cannot be identified to be properly credited to loans receivable and interest income accounts.

6.3 Review of the Undistributed Collections account from 2010 to 2014 or five years, disclosed that the total amount of P1,375,128 was reclassified to Miscellaneous Income account, details shown below:

Date	Journal Voucher No.	General Ledger Account	Amount
12/31/10	JV-10-12-413-D	Other Operating Income -Misc	P 191,228
12/31/10	JV-10-12-414-D	Other Operating Income -Misc	148,562
12/31/10	JV-10-12-415-D	Other Operating Income -Misc	146,553
12/31/10	JV-10-12-416-D	Other Operating Income -Misc	16,350
07/31/11	JV-11-07-093	Miscellaneous income	137,084
08/31/11	JV-11-08-104	Miscellaneous income	49,064
11/30/11	JV-11-11-100	Miscellaneous income	78,653
04/30/12	JV-12-04-025	Miscellaneous income	4,257
08/31/12	JV-12-08-184	Miscellaneous income	324,061
12/31/12	JV-12-12-060	Miscellaneous income	37,000
08/31/13	JV-13-08-040	Miscellaneous income	63,600
08/31/13	JV-13-08-041	Miscellaneous income	30,715
12/31/13	JV-13-12-190	Miscellaneous income	78,001
09/26/14	JV-14-09-083	Miscellaneous income	50,000
12/31/14	JV-14-12-364-B	Miscellaneous income	20,000
TOTAL			P **1,375,128**

6.1 As a result of the above practice, both the Loans Receivables and Miscellaneous Income accounts were overstated.

6.2 We recommended that Management:

> **a. Prepare adjusting journal entries to revert back the Undistributed Collections amounting to P1.375 million in the books.**
>
> **b. Create a team to conduct confirmation of accounts and payments made on the loan accounts;**
>
> **c. Post the identified undistributed collections to the proper Borrower's account; and**
>
> **d. Ensure that Undistributed Collections account is properly administered and controlled to ensure that operating policies and procedures are in effect like, establishing the acceptable length of time an item may remain unadjusted/unidentified.**

6.3 Management commented the following:

1. The undistributed collection refers to unidentified deposits made to SBC deposit account with LBP from the different branches nationwide. Those which were identified were correspondingly adjusted and those which remained in the list for more than five years were eventually recognized as miscellaneous income in compliance with a Management Committee (MANCOM) resolution issued in reply to the same BSP findings in its examination of 2011. However, they maintained a list of those deposits which were closed to Miscellaneous Income for reference purposes in case a borrower later on comes forward and claims such deposit in payment of his/her loan account.

6.4 As a rejoinder, we maintain our stand that Undistributed Collections should not be closed to Miscellaneous Income. The nature and the borrowers' payments booked as Undistributed Collections should be identified and be properly posted to their respective accounts.

7. Collections from loan payments amounting to P2.011 million lodged to Undistributed Collections account as of December 31, 2014 temporarily remain unapplied, thus, Loan Receivables and Undistributed Collections were overstated while interest income was understated contrary to the provisions of Philippine Accounting Standards (PAS) No. 1.

7.1 Paragraph 3 of PAS No. 1 - Presentation of Financial Statements states that:

> *Financial statements shall present fairly the financial position, financial performance and cash flow of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. xxx..*

7.2 The MOA of SBC with the Land Bank of the Philippines (LBP) dated July 6, 2007 on SBC's availment of the LANDBANK's On-Line Collection Facility for the acceptance of loan payments from their borrowers states that:

A.*3 The LANDBANK branches shall accept only those deposits with complete information as to the Borrower's Name, PN Number and amount. Incomplete information on the deposit slip would mean non-acceptance of deposit/payment.*

xxx

B.2 SBGFC shall communicate with all loan borrowers about the provision of this Agreement and the Clearing Account Number to be used for the deposits/payments.

7.3 Verification of aging schedule of undistributed collections disclosed that the identification of payments/collections is a recurring problem. To date, even with the implementation of LBP On-Line Collection Policy since 2007, a total of P1,631,420 or 81% of the outstanding balance of P2,010,597 were booked in 2014 as follows:

Age	Amount
1 day to 30 days	307,838
31 days to 360 days	1,323,581
361 days and beyond	379,178
Total	**2,010,597**

7.4 A total of P1,268,185 or 7.4% are cash payments from unidentified borrowers which have remain unapplied from eight days to two years and beyond from receipt thereof and are still for tracing/reconciliation.

7.5 From the Table above, it could be inferred that the bulk pertains to balances in the year of audit. The length of time an item remains in the control account reflects on the entity's operational efficiency and even poses a higher risk potential as the transactions are incomplete and require manual processing to be completed.

7.6 Since the collections remain unapplied, the Loans Receivables and Undeposited Collection accounts were overstated and Interest Income was understated, thus, making the Financial Statements unreliable and did not fairly present the financial position of the Corporation.

7.7 **We recommended that Management:**

a. Communicate with LBP and all loan borrowers about the provisions of the On-Line Collection Loan Facility Agreement particularly on the complete information in making deposit/payment of loan accounts;

b. Prioritize the reconciliation of accounts. Create a team to conduct confirmation of accounts and payments made on the loan accounts. Cause the immediate application of the undistributed collections; and

c. Ensure that Undistributed Collections account is properly administered and controlled to ensure that operating policies and procedures are in effect like, establishing the acceptable length of time an item may remain unadjusted/unidentified;

SBC-Northern Luzon Group (NLG)

8. A total of 107 Promissory Notes amounting to P188.277 million were not properly acknowledged before a notary public, thus, prejudicial to the interest of SBC NLG.

8.1 One of the required documents prior to loan release is a notarized promissory note (PN). A PN is a legal instrument in which one party promises in writing to pay a determinate sum of money to the other either at a fixed or determinable future time or on demand of the payee, under specific terms. Aside from the promise to pay the loan and its interests, the borrowers also declare in the PNs the agreement on specific terms, such as changes in rates of interest, penalty rates for failure to pay amortizations due, action of holder in the event the note or any part thereof is not paid in accordance with its term, and waiver of rights.

8.2 The PN as a negotiable instrument is to be properly acknowledged before a notary public. The rationale is that once a PN is notarized, it becomes a public document, hence, there is no need to prove its due execution in case of litigation. The purpose of the acknowledgment is to minimize fraud.

8.3 “Acknowledgement” as defined under Section 1, Rule II of the 2004 Rules on Notarial Practice refers to an act in which an individual on a single occasion:

a) appears in person before the notary public and presents an integrally complete instrument or document;

b) is attested to be personally known to the notary public or identified by the notary public through competent evidence of identity as defined by these Rules; and

c) represents to the notary public that the signature on the instrument or document was voluntarily affixed by him for the purposes stated in the instrument or document, declares that he has executed the instrument or document as his free and voluntary act and deed, and, if he acts in a particular representative capacity, that he has the authority to sign in that capacity.

8.6 Our audit of loan releases revealed that of the 149 PNs reviewed, 107 were acknowledged by a notary public prior to the date of execution as follows.

	Qty	**Amount**
Structured Loans	76	56,197,400
Wholesale Loans	31	132,080,000
Total	107	188,277,400

8.7 Based on the dates of notarization on the 107 PNs, the acknowledgement that the instrument was executed freely and voluntarily was done before the date of execution. It is to be believed then that the PNs lacked the signatures of the executing parties when these were presented to the notary public for acknowledgement. This is contrary to the definition of "Acknowledgment" as cited above.

8.8 The improper acknowledgement of the PNs may prove to be disadvantageous to SBC in cases where the borrowers fail to pay amortizations due and the SBC have to resort to litigations to collect unpaid loans.

8.9 We recommended that Management require the Account Officers to see to it that promissory notes submitted by borrowers are properly acknowledged to protect the interest of the SBC and avoid future legal repercussions that may be prejudicial to the agency.

8.10 Management commented the following:

a. The Manager explained that due to the distance and geographical locations of most borrowers and the need for a timely loan release, all loan documents needing the signature of the borrowers were prepared at the SBC NLG Office then sent to the borrower instead of the borrower going to the SBC Office. The loan documents including the PNs were post-dated to allow the borrowers enough time to comply with documentary requirements before the loan is released. It is the policy that the date of the PN is the date of loan release. The borrowers were required to have the PNs notarized or acknowledged and be personally present in front of the notary public before the documents are returned to the SBC, thus, the notarization before the date of execution indicated by the SBC on the document.

b. The absence of notarization does not necessarily invalidate the transaction evidenced in the promissory note. Article 1358 of the Civil Code requires that the form of a contract that transmits or extinguishes real rights over immovable property should be in a public, yet it is also an accepted rule that the failure to observe the proper form does not render the transaction invalid. (Zenaida B. Tigno et al. v. Spouses Estafino Aquino, G. R. No. 129416, 25 November 2004). Moreover, even assuming arguendo that these PNs were acknowledged by a notary prior to the date of execution, the fact that they were notarized it already carried in its favour the presumption of regularity with respect to its due execution, and that there must be clear, convincing and more than merely preponderant evidence to contradict the same. (see Tigno v. Spouse Aquino, supra).

c. Also, for other documents that are to be signed by officers from the Head Office, these are subscribed and sworn to before the undersigned.

d. In any case, we submit to the Auditor's recommendations that the PNs submitted by the borrowers must be properly acknowledged. The Legal Services Group will and review closely coordinate with the NLG and review the procedures for notarization of documents, and to ensure the NLG's compliance with the 2004 Rules on Notarial Practice.

e. SBC Head Office commented that they will ensure full notarization of all pertinent loan documents. As explained in the exit conference, there are exceptional cases when the notarization could not be implemented prior to loan releases for very distant borrowers. The notarization is done on a post loan release basis. A policy will be adopted for setting a five-working day deadline for the post release notarization.

8.11 As a rejoinder, the Management's justification is duly noted. However, we maintain our recommendation that the PN are to be properly acknowledged. Acknowledgement done on or after the PN dates is to be the norm and not exceptions. We believe that it is to the best interest of the SBC if the PNs are without deficiency and acknowledged in accordance with Section 1, Rule II of the 2004 Rules on Notarial Practice.

9. Mortgage of collaterals offered by 15 borrowers for loans totalling to P17.797 million as of November 30, 2014 were not registered with Registry of Deeds (RD) contrary to the pertinent provisions of Presidential Decree (PD) No. 1529 and Act 1508 (Chattel Mortgage Law), thereby, exposing the Corporation to losses or undue claims from third parties. Mortgaged properties are not adequately described in the list and description of properties mortgage, thus providing difficulty in the identification and does not facilitate transfer of ownership from the mortgagor to the mortgagee upon non-fulfillment of obligations.

9.1. PD No. 1529, otherwise known as "An Act Amending and Codifying the Laws Relative to the Registration of Property and for Other Purposes", states:

> *"Section 51. Conveyance and other dealings by registered owner. An owner of registered land may convey, mortgage, lease, charge, or otherwise deal with the same in accordance with existing laws. He may use such forms of deeds, mortgages, leases or other voluntary instruments as are sufficient in law. But no deed, mortgage, lease, or other voluntary instrument, except a will purporting to convey or affect registered land shall take effect as a conveyance or bind the land, but shall operate only as a contract between the parties and as evidence of authority to the Register of Deeds to make registration.*
>
> <u>*The act of registration shall be the operative act to convey or affect the land in so far as third persons are concerned, and in all cases under this Decree, the registration shall be made in the office of the Register of Deeds for the province or city where the land lies.*</u>
>
> *Section 54. Dealings less than ownership, how registered. No new certificate shall be entered or issued pursuant to any instrument which does not divest ownership or title from the owner or from the transferee of the registered owners. All interests in registered land less than ownership shall be registered by filing with the Register of Dees the instrument which creates or transfers or claims such interests and by a brief memorandum thereof made by the Register of Deeds upon the certificate of title, signed by him. A similar memorandum shall also be made on the owner's duplicate.* <u>*The cancellation or extinguishment of such interest shall be registered in the same manner.*</u>
>
> *Section 60. Mortgage or lease of registered land. Mortgage and leases shall be registered in the manner provided in Section 54 of this Decree. The owner of registered land may mortgage or lease it by executing the deed in a form sufficient in law.* <u>*Such deed of mortgage or lease and all*</u>

instruments which assign, extend, discharge or otherwise deal with the mortgage or lease shall be registered, and shall take effect upon the title only from time of registration. (underscoring supplied)."

9.2. The Chattel Mortgage Law, Act No. 1508, similarly provides the following:

Section 4 Validity – A chattel mortgage shall not be valid against any person except the mortgagor, his executors or administrators, unless the possession of the property is delivered to and retained by the mortgagee or unless the mortgage is recorded in the office of the register of deeds of the province in which the mortgagor resides at the time of making the same, or, if he resides without the Philippine Islands, in the province in which the property is situated: Provided, however, That if the property is situated in a different province in which the mortgagor resides, the mortgage shall be recorded in the office of the register of deeds of both the province in which the mortgagor resides and that in which the property is situated, and for the purposes of this Act the city of Manila shall be deemed to be a province.

Section 7. Description of property. – The description of the mortgaged property shall be such as to enable the parties to the mortgage, or any other person, after reasonable inquiry and investigation, to identify the same. x x x A chattel mortgage shall be deemed to cover only the property described therein and not like or substituted property thereafter acquired by the mortgagor and placed in the same depository as the property originally mortgaged, anything in the mortgage to the contrary notwithstanding.

9.3. Review of collateral documents submitted by 27 sample borrowers with real estate mortgages (REMs) disclosed that 11 borrowers with total loans of P14,607,200 as of November 30, 2014, had REMs that were not registered or annotated in the titles (TCTs)/ tax declarations (TDs) as follows:

Borrower	Loan Granted	Amount Unregistered REM/Supplemental REMs
A	P 1,500,000	P 1,000,000
B	200,000	200,000
C	800,000	400,000
D	1,997,200	1,250,000
E	1,000,000	1,000,000
F	500,000	500,000
G	200,000	200,000
H	5,322,500	5,000,000
I	1,087,500	500,000
J	1,200,000	500,000
K	800,000	800,000
TOTAL	**P 14,607,200**	**P 11,350,000**

9.4. Likewise, chattel mortgages of collateral offered by four borrowers with approved loans amounting to P3,190,000 were not duly registered as follows:

Borrower	Amount of Loan Granted	Amount of Unregistered REM
L	P 290,000	P 290,000
M	400,000	400,000
N	2,000,000	2,000,000
O	500,000	500,000
TOTAL	**P 3,190,000**	**P 3,190,000**

9.5. We noted that, except for Borrower M, the mortgaged properties offered by the other three borrowers were not sufficiently described in the List and Description of Properties Mortgaged that is attached to the mortgage document. The serial numbers of the computers and equipment were not indicated to prevent any substitution.

9.6. Non-registration of the mortgages and insufficient description of mortgaged properties are contrary to the above cited provisions of PD No. 1529 and Act No. 1508, which is disadvantageous to the interest of the Corporation. The SBC is exposed to greater risks of loss and undue claims from third parties.

9.7. The absence of registration of the collateral documents in the custody of the Corporation does not bind the land and or property to the holder. It is only when such is duly registered and annotated that the mortgagee technically becomes the owner of the portion of the mortgage, notwithstanding the fact that the title to the property is still in the name of the mortgagor. Thus, the interest of the Corporation is not secured and recovery of its investment will not be facilitated in case of default by the borrowers.

9.8. There is also an increased risk that substitution of mortgaged property by the mortgagor will not be easily detected by the Corporation because of insufficient description. This again is not in the best interest of the Corporation.

9.9 We recommended that Management:

a. Require the registration of all mortgages subject of this observation and all future mortgages to comply with the pertinent provisions of PD No. 1529 and Act No. 1508 to protect the interests of the Corporation; and

b. Require the Account Officers to ensure that mortgaged properties are adequately described for accurate identification when necessary and to facilitate transfer of ownership from the mortgagor to the mortgagee upon non-fulfillment of obligations.

9.10 Management commented the following:

a. SBC-NLG Management explained that since extension of credits to Micro, small and medium enterprises (mSMEs) are based mainly on the Borrower's Risk Rating score under the Risk-Based approach, collaterals are not always required at the NLG level of authority, which is P1 million for clean loan and P1.5 million for partially secured loans. Whenever collaterals were accepted, the required registration was not strictly done so as to minimize expenses on the part of the borrowers.

b. SBC Head Office commented that registration of all collaterals securing retail loans will be complied with. Assets of the borrower that are not for annotation shall no longer be accepted as collateral. The impact of collateral cover under SBC's risk-based lending credit strategy is only on the interest rate and on amounts more than P2.0 million which is the threshold of SBC for clean loans. Should SBC require collateral on loan amounts not more than P2.0 million, these shall be for annotation. If the cost of annotation does not make sense given the small amount of value of the supposed collateral or given the circumstances of the borrower as in the case of calamity-stricken Micro, Small and Medium Enterprises (mSMEs) then the supposed collateral shall no longer be required.

9.11 We informed Management of the following rejoinder:

a. While we recognize SBC's efforts in helping the growth of mSMEs to the extent that as much as possible, borrowers are spared from additional expenses, however, the registration of mortgages is required by law, particularly Article 2125, Chapter 3 of the Civil Code of the Philippines. Collaterals may not be always required by the SBC but since these were accepted, prudence dictates that all measures to protect the interest of the Corporation on the mortgaged properties be carried out.

b. As stated during the exit conference, the SBC NLG management is answerable, not only to the mSMEs but also to the government. It should also consider that government funds are to be protected against losses due to unpaid loans and that in order to be of help to the mSMEs, SBC funds are to be sustained.

c. We maintain our recommendation that the mortgages be registered in accordance with existing law, rules and regulations.

10. Insurance coverage and updating of real property tax payment of loan collaterals were not required of borrowers contrary to Section X311.3 of the Manual of Regulations for Banks, BSP Circular No. 247, and sound industry practice, thereby exposing the Corporation to risk of non-indemnity in case of fortuitous events or incurrence of additional expenses in case of foreclosure.

10.1 Section X311.3 of the Manual of Regulations for Banks (MORB) on insurance of real estate improvements states:

> "The required insurance on improvement used as collateral for loan should be such as shall be sufficient to secure seventy per cent of the appraised value of such improvements or if inadequately insured, the loan value shall correspond to the extent of insurance taken on such improvement."

10.2 Similarly, BSP Circular No. 247, series of 2000 cited:

> "Loans with collaterals not insured or with inadequate/expired insurance policies or the insurance policy is not endorsed in favor of the bank" as an example of exception that should be brought to management's attention for corrective action.

10.3 Contrary to the cited provisions, we noted in the Loan Agreement Memorandum (LAM) and REM contracts that insurance coverage and the endorsement of the insurance policy to the SBC for mortgages was not required of eight borrowers whose collaterals included improvements or structures/buildings as follows:

Borrower	Appraisal Date	Market Value of Improvement	Loan Value of Improvement
A	08-15-2012	P 3,649,166	P 2,189,499
B	08-31-2012	4,470,265	2,682,159
C	01-11-2012	837,276	502,366
D	02-12-2012	304,000	182,600
E	(not indicated)	293,000	175,800
F	4-2-2013	768,000	460,800
G	1-31-2013	14,221,600	8,532,960
H	6-4-2012	430,950	258,570
Total		**P 24,974,257**	**P 14,984,754**

10.4 The SBC, as the mortgagee, has conditional right and interest on the properties accepted as collaterals for loans granted. Due diligence as that of a good father of a family dictates that such interest is to be protected. Protection of its interests on loan collaterals includes the requirement that real property tax payments are to be updated.by the borrowers in accordance with Section 56 Chapter VI of the Real Property Tax Code of the Philippines which states that "The real property of tax for any year shall attach and become due and payable on the first day of January and from the same date said tax and all penalties subsequently accruing thereto shall constitute a lien upon the property subject to such tax. Said lien shall be superior to all other liens, mortgages, or encumbrances of any kind whatsoever, shall be enforceable against the property whether in the possession of the delinquent owner or possessor, and shall be removable only by the payment of the delinquent taxes and penalties."

10.5 Further verification revealed that 12 borrowers were not required to submit receipts to prove that payments of real property taxes on the mortgaged property are up-to-date.

10.6 Lack of insurance coverage over the real estate improvements exposes both the borrower and the Corporation to risk of non-indemnity in case of fortuitous events leading to loss of or damage to the mortgaged property.

10.7 Failure to require submission of receipts to ensure that payments of real property taxes are up-to-date would also result in additional expenses in the event these properties are to be foreclosed. In October 2014, the SBC had to pay P1,870 for taxes and penalties of a property that was foreclosed. This expenditure could have been avoided had the borrower been required to submit proofs of payment of real property taxes after the property had been accepted as collateral.

10.8 We recommended that Management:

a. Require the eight borrowers above to insure the mortgaged improvements/structures and indorse the corresponding insurance policy to the SBC;

b. Require the 12 borrowers above to submit official receipts (ORs) for updated real property taxes of mortgaged properties; and

c. Propose to higher authorities the possible amendment of the LAM and the REM Contracts to include the following requirements to:

1) Insurance of mortgaged improvements and indorsement of the insurance policy to the SBC; and

2) Submission of ORs to show up-to-date payment of real property taxes.

10.9 Management commented the following:

a. SBC-NLG admitted that insurance is necessary when SBC has an interest on the improvement or when the improvement had been financed by the SBC. However, the terms and conditions in the LAM may not include the requirement that mortgaged improvements are to be insured if the value is minimal compared with SBC exposure. Management agreed that borrowers are to be required to submit receipts as evidence that payment of real property taxes is updated.

b. SBC Head Office replied that for loans exceeding to P2.0 million (which is SBC's clean loan threshold) and for loans whose interest rate took into consideration the value of real estate cover, this requirement will be added in the loan covenants. Compliance by the borrower shall be checked during the Borrower's Risk Rating (BRR) review schedule.

10.10 As a rejoinder, Management's explanation was duly noted. Management acknowledged that insurance is necessary when SBC has an interest on the improvement or when the improvement had been financed by the SBC. Precisely, the SBC has an interest on the mortgaged property, be it financed by SBC or not.

Thus, we maintain our recommendation since the insurance of the mortgaged property and subsequent indorsement of the policy to SBC is a necessary precaution to further protect the SBC from losses.

SBC-Visayas Group (VG)

11. In-house financial statements (FS) were used in the evaluation of the credit standing and financial capacity of the borrowers instead of the submitted Bureau of Internal Revenue (BIR)-filed FS as required under subsections 4312Q.1 and 4312N.1 of the Manual of Regulations for Non-Bank Financial Institutions

(MORNBFI), as amended by Bangko Sentral ng Pilipinas (BSP) Circular No. 622 dated September 16, 2008.

11.1 Subsections 4312Q.1 and 4312N.1 of the MORNBFI, as amended by Circular No. 622 dated September 16, 2008 of BSP, provides the requirements from credit applicants as follows:

a. A copy of the latest Income Tax Return (ITR) of the borrower and his co-maker, if applicable, duly stamped as received by the BIR; and

b. Except as otherwise provided by law and in other regulations, if the borrower is engaged in business, a copy of the borrower's latest financial statements as submitted for taxation purposes to the BIR.

11.2 The submission of these documents are necessary to obtain adequate information on the borrowers' credit standing and financial capacities and to ascertain that the financial statements presented and submitted for evaluation are valid and correct;

11.3 The SBC Credit Policy Manual defines credit risk as *"the risk that the borrower may not be able or willing to repay all the money he or she owes in accordance with loan contracts"*.

11.4 Further, the Credit Policy Manual also says that: *"The establishment of a clear, sound and effective set of policies and guidelines on credit is intended to help the corporation deal with credit risks."*

11.5 Among the tools and instruments being used by SBC to help control credit risk is a BRR System. It is one of the bases for loan approval. All loan applications must pass the BRR 5 which is of acceptable risk. Below this passing mark means denial of application. It is also used as bases for monitoring activities.

11.6 The BRR is used as reference to set the price, term and amount of the loan. Likewise, the BRR has a bearing on the decision to set the term and the amount of the loan.

11.7 We observed that Financial Statements used in the evaluation of borrowers' credit standing and financial capacities and the computation of ratios in the BRR are the "In-house FS" or FS prepared by the borrower or his/her accountant to be used for loan application with SBC, and not the financial statements prepared and filed with the BIR.

11.8 In CY 2014 there were 37 regular loans released. We verified 15 loan folders and noted that 13 of the BRRs attached were prepared based on "In-house FS."

11.9 The practice of not using the required documents, data and/or information, prevented management to conduct a thorough evaluation of the borrowers' credit standing and financial capacities and come up with a reliable BRR, which may consequently result in possible loss of government funds due to delinquent/past due accounts and/or non-payment of loans by the borrowers.

11.10 We recommended that Management conduct proper evaluation of the credit standing and financial capacity of the borrowers thru:

> **a. Strict compliance with the provisions of MORNBFI Sub-sections 4312Q.1 and 4312N.1, and BSP Circular No. 622; and**
>
> **b. The use of the Audited Financial Statement submitted or filed with the BIR in the preparation of the BRR, instead of the "in-house FS" of borrowers.**

11.11 Management commented the following:

> a. SBC-VG commented that one of the major indicators under the BRR system is the Debt Servicing Capacity (DSC) which comprises the highest point of 30% in the rating. The DSC shows the ability of the borrower to meet his obligation. The computation of the DSC involves net income, drawings/ dividends, interest expense, depreciation expense and the loan payables/obligations for the incoming year. In order to get the realistic DSC and thus come up with the least risky (in terms of debt servicing) loan account, actual financial operations (or at least the closest to it) are necessary. In many instances, there are loan obligations by the borrower that are not reflected in the financial statements which they only come to know upon the interview. This amount also needs to be incorporated in the evaluation. The SBC then, agency-wide, uses the in-house FS as our basis for evaluating the BRR. In cases where the applicant-borrower only prepares the audited FS (BIR-filed FS), they use what is submitted.
>
> In no case however, that they forego with the submission of the latest BIR-filed ITR and FS. One of the minimum documentary requirements is the submission of the document which MUST reflect a positive income. Otherwise, the application is automatically declined.
>
> b. SBC Head Office commented that BIR-filed audited financial statements as basis for credit evaluation. BSP Circular No. 855, series of 2014 waives this requirement for "loans and other credit accommodations not exceeding P3.0 million"; Loans to start up enterprise three (3) borrower's during the first three (3) years of the operations or banking relationship**."**

11.12 We maintain our stand that BIR-filed FS should be used in the BRR evaluation, instead of in-house FS. SBC, being a non-bank financial institution, is subject to the rules and regulations of the BSP. As a government agency it is bound to adhere to these rules to protect the interest of the government. Also, using BIR-filed FS as basis for BRR would encourage the applicant-borrowers to reflect the true and correct financial standing of the company and its operations and to file the same with the BIR. Likewise, accepting in-house FS would lead them to believe that it is alright not to have two sets of FS: one for the BIR and one as in-house FS.

In addition, we also suggested that there are more effective validation procedures than what they are currently doing, such as obtaining written confirmation of receivables from borrowers' suppliers rather than just thru phone calls; and the conduct of actual physical inventory, instead of mere ocular inspection.

SBC-Mindanao Group (MG)

12. Laxity in granting the advance drawdown to a Rural Bank (RB) amounting to P4.905 million under the SME-Wholesale Program (WP) and Graduating Micros Wholesale (GMW) credit facility is contrary to its Risk-Based Lending (RBL) Framework and Section A, Chapter II of SBC's Credit Policy Manual (CPM) resulting in additional exposure of loan losses in view of the bank's closure.

12.1 SBC has a RBL Framework under the CPM, which states that:

> *"Risk-based lending framework encourages the loan evaluators to primarily consider the borrower's business viability and the capacity to generate sufficient income to repay its loan over collateral consideration. This calls for a closer study and management of the SMEs' operational, financial, management and market risks."*

12.2 Section A, Chapter II of SBC's CPM provides –

> *"c. Maintain an appropriate credit administration, measurement and monitoring process.*
>
> *c.3 Part of the post-credit review function of the credit review team is to ensure that the credit files include all the necessary information of the borrower such as, current financial statements, internal rating reports, approval media, credit investigation and appraisal reports, customer information sheet, and call report."*

12.3 Based on the records provided by the Corporation as of December 10, 2014, the loan outstanding balance of the subject RB under the SME-WP and GMW amounted to P4,297,500.

12.4 Our audit disclosed that the Corporation released an advance drawdown of the said loan amounting to P4,905,000 to the subject RB on July 16, 2013 although the bank had already experienced liquidity problem. Hence, the said RB issued a letter dated August 27, 2013 to SBC requesting for loan restructuring.

12.5 Review of the Call Report by the Account Officer of SBC regarding her visit at said RB on September 12, 2013 disclosed that its audited FS for CY 2012 and June 30, 2013 were only submitted to SBC on September 10, 2013. Thus, said documents were not yet evaluated prior to the release of loan on July 16, 2013.

12.6 The evaluation of its financial statements is essential to ensure and/or establish the viability and liquidity of the bank and assess the capacity of the borrower to repay its loan.

12.7 Had SBC carried out its function to identify, monitor and control credit risk, especially prior to granting of additional loan to the subject RB, SBC's additional exposure of loan could have been avoided and mitigated its losses in view of the bank's closure.

12.8 **We recommended that Management:**

a. Submit a written explanation as to why there is no post-credit review conducted on the current financial statements of subject RB prior to the release of additional loans; and

b. Revisit the post-credit review function of the Credit Review Team to closely monitor and assess the capacity of the borrower to pay its loan before granting additional loans.

12.9 SBC-Mindanao Group commented the following:

a. Per SBC established guidelines/procedures, all partner financial institutions (PFIs) are evaluated based on the overall financial condition prior to the granting of an Omnibus Credit Line (OCL). During the credit evaluation stage, PFIs are required to submit the latest year-end BIR-filed/audited FS and latest interim FS as one of the basis in evaluating the loan application. All credit recommendations pass through the Credit Review Department (CRD) for checking prior to credit decision by approving authority. All approved loans have specific terms and conditions and schedules monitoring activities including quarterly financial assessment during the term of the line. Should the PFI financial indicators in any quarter fall below the SBC minimum requirement, clearance from the CRD is required before any additional loan release.

b. The PFIs are required to submit the quarterly in-house or BSP format FS as basis for the quarterly financial assessment. Per SBC guidelines, FS Assessment of FS ending March 31 should be available not later than June 1 and is valid until September 1; FS Assessment for June 30 FS is due September 1 and is valid up to December 1 and so forth. On the other hand, Credit Investigation Report has a validity of 6 months based on CY 2013 credit guidelines.

c. The July 16, 2013 loan release of P4,905,000 to RB, as advance drawdown per FAST-PN-2013-15497 and its subsequent liquidation documented by eight new PNs on August 15, 2013 were made in accordance with established SBC credit guidelines/procedures stated in items a and b above. The 2013 first quarter Financial Assessment was cleared by CRD. That time, the RB 2012 audited FS was not available yet to SBC, which is a requirement for its OCL renewal come December 6, 2013.

d. The required monitoring and BRR review were all complied by the concerned Account Officer per schedule.

e. Despite the compliance to all risk mitigating measures, the account of RB turned past due.

f. The RB major problem started when its area of operations, which are Comval, Davao Oriental and Davao del Norte were severely hit by Typhoon Pablo in December 2012. The cash collections from the loans dropped, as the borrowers, especially the micros, lost the livelihood during the storm. The severe effect of the storm was only felt by RB early third quarter of 2013 when it can no longer fund its maturing post-dated checks. They requested for moratorium on loan payments to include the following creditors with outstanding balance as of June 30, 2013; PCFC - P6.325 million; NLDC - P20.375 million; LBP - P12.021 million; UCPB – P9 million.

g. In another development, the RB appealed to BSP for a staggered increase in loan loss provisioning rather than outright charging to CY 2012 operations. However, the external auditor can no longer wait for BSP decision, thus he finalized the audit report in June 2013 thereby recognizing in full the P15.5 million BSP required loan loss provision and thus resulting in a deficit of P16.4 million. The audited FS was filed with BIR on June 28, 2013 and was only made available to SBC in September 2013.

h. Due to heavy net loss declared, RB capital restoration plan failed as two prospective investors backed out. On the other hand, the Torres family who are the major stockholders also lost appetite in pouring in fresh funds. Thus, to protect the depositors, RB management decided to voluntarily close the bank on March 7, 2014.

i. They exerted all effort to get the real picture of the financial condition of any borrower including RB in order to make sound credit decision. They strictly follow established SBC credit guidelines/procedures in implementing loan releases and in monitoring borrowers. However, in any credit decision, there is always a risk factor especially if the borrower is not transparent in the dealings. The intervening events describe in items above were beyond the control.

12.10 SBC Head Office commented the following:

a. The "clearance to release" signed by the CRMG Head, Ms. Monterey despite the 16.2% Past Due Rate (PDR) and Portfolio at Risk (PAR) of 11.2% as of March 2013, was in view of the updated figure of 15% and 7.5%, respectively as of May 2013. These updated figures were based on the report on aging of past due loans submitted by RB to the MG which was requested upon the instruction of Ms. Monterey.

b. The June 2013 FS of RB would indeed have been helpful in avoiding new loan releases by SBC to the PFI. The said FS registered a net loss of P12.8 million as of said period. The FS was not yet available for review as of loan release on July 16, 2013.

c. An analysis of the June 2013 FS, the March 2013 FS which was what MG and CRMG reviewed as basis for the allowed loan drawdown, reveal that there was an unusual marked increase in Interest Expense in the second quarter, and a significant decrease in Interest Expense was almost P6.0 million higher than the pro-rated figure and Interest Revenue was P8.0 million lower.

d. As with the case of the former CRBB account, there could have been a case of lending at low rates to clients who were at the time given high yields for the deposit accounts.

e. The expectation of COA that SBC should have seen the liquidity problem of the bank much earlier is not feasible given that even as of June 2013, the liquidity ratio was at 33%; and

f. Per Credit Investigation Report (CIR) of MG, the other creditors of the rural bank were LBP, UCPB-CIIF, NLDG, PCFC and BSP.

g. Moving forward, the suggestion of the Internal Auditor that FS to be used in the FS Assessment should be from here on as of latest month needs to be considered for immediate adoption.

h. SBC Head Office commented that the recommendation of COA and the SBC Internal Auditor that the FS assessment should be based on a more timely FS of the PFI is appropriate. A policy will be adopted requiring a more recent instead of the existing one-quarter allowance for the report. There is basis for requiring that the FS should not be more than one month old. They need to validate the feasibility of this policy through further consultation. They shall give the feedback before the end of July 2015.

12.11 Rejoinder:

1. During the exit conference, Ms. Eyas acknowledged that she was not able to evaluate the audited FS of RB and was not able to compare the audited FS and in-house FS because the audited FS was not yet available. However, she stressed that in the existing credit policy, in case the current FS is not available, an evaluation or assessment of in-house FS will suffice. Also, she cited that the CIR is valid for six months based on 2013 credit guidelines.

2. Since the SBC's credit policy is risk-based and not based on collateral, MG shall consider identifying the risk that may occur in every grant of loan.

3. We acknowledge the justification of SBC MG as to the cause of why the account of RB turned past due. However, precautionary measures could have been made through thorough evaluation and validation of the current FS before processing and approval of additional loan. Since the Audited FS of the RB for CY 2012 and June 2013 were not yet available, the processing and approval of advance drawdown could have been postponed. Thorough evaluation and validation of the RB's financial status could have been conducted and additional exposure of loan could have been avoided.

13. Notices of Disallowances (ND) issued as at December 31, 2014 amounted to P8.816 million.

13.1 The Summary of Suspensions, Disallowances and Charges as at December 31, 2014 follows:

	Suspensions	Disallowances	Charges
Beginning, December 31, 2013	-	P 3,753,663	-
Add: Issuances	-	5,248,044	-
Less: Settlement	-	185,683	-
Ending, December 31, 2014	-	P 8,816,024	

13.2 In 2014, we issued Notice of Disallowances with a total amount of P5,248,044 representing payments of salary differentials on merit increase/ length of service to SBC officials and personnel, which is currently under appeal.

Part III

STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

Out of the 15 audit recommendations embodied in the prior years' Annual Audit Report, eight were fully implemented, four were partially implemented and three were not implemented. The recommendations that were partially and/or not implemented are as follows:

OBSERVATIONS AND RECOMMENDATIONS	ACTION TAKEN/COMMENTS
1. The Transfer Certificates of Titles (TCTs) submitted to the Corporation by two borrowers with outstanding loan balances totaling P65.536 million are defective contrary to the provisions of Presidential Decree No. 1529, thereby adversely affecting the consolidation of titles; the disposal of property and the recovery of the Corporation's investments.	
a. Ensure compliance with the pertinent provisions of Presidential Decree No. 1529;	**Partially Implemented.**
b. Ensure that TCTs presented by borrowers are clean or free from liens or encumbrances and that subsequent mortgages and other instruments attached to the Titles are registered with the Registry of Deeds to facilitate the transfer of title from the mortgagor to the mortgagee upon non-fulfillment of obligations;	SBC filed a claim with PDIC for all outstanding obligations and has been collecting directly from sub-borrowers. From the loss of P46.3 million, outstanding balance now is P26.7 million
c. Annotate/register with Land Registration Authority (LRA) the Deed of Assignment on the TCTs listed in existing inventory of collaterals to ensure that the funds invested by the Corporation are protected from losses or undue claims from third parties; and	
d. For closed banks, coordinate closely with the Philippine Deposit Insurance Corporation (PDIC) and LRA for the recovery/protection of SBC's interest.	
2. A total of 22 items of acquired assets with total book value of P13.465 million are still undisposed as at December 31, 2013, thus requiring additional expenses for their	

OBSERVATIONS AND RECOMMENDATIONS	ACTION TAKEN/COMMENTS
maintenance and depriving the Corporation from early recovery of its investments.	
a. Facilitate/expedite disposal of Acquired assets that are already consolidated in the name of Corporation; b. Make representations with the DAR for the Acquired assets that have been identified to be covered by the CARP and secure appropriate compensations for the transferred land; c. Make representations with DBP and bill them for property already sold; d. Pursue legal action or other measures in asserting the rights of SBC over the acquired property occupied by former owners/ illegal settlers; and e. Apprise us on the status of accounts with pending legal cases.	**Partially Implemented**. Reiterated with updates in Audit Observation and Recommendation No. 3. Out of 22 acquired assets, only 14 are available for sale. Two items were disposed in 2014.
3. Three foreclosed property with a total appraised value of P1.731 million have not been consolidated in favor of SBC notwithstanding the expiration of redemption period thus, preventing the disposal of the acquired assets.	
a. Maximize efforts to immediately act and comply with the procedural and documentary requirements to expedite the consolidation of titles in the name of SBC e.g. correction of title and securing clearances, among others; and b. Comply strictly with the regulation of SBC to consolidate the titles of foreclosed property in its name after expiry of the redemption period.	**Partially Implemented.** In 2014, one property was already consolidated in the name of SBC and other two are in the process of consolidation.
4. Payment of Collective Negotiating Agreement (CNA) incentive in CY 2012 for SBC personnel in the amount of P1,196,250 was disallowed in audit, under appeal.	
Management should settle the Notice of Disallowance**.**	**Not Implemented.** Part of Observation No. 13.

OBSERVATIONS AND RECOMMENDATIONS	ACTION TAKEN/COMMENTS
5. Reimbursement of Business Promotion Expenses incurred by Members of the Board of Directors (BOD) in CY 2004 totalling P680,730 was not properly supported.	
Management should settle the Notice of Disallowance.	**Partially Implemented.** With Notice of Finality of Decision (NFD) dated June 18, 2014. Management issued Notices of Collections to concerned members of BOD.
6. Payment of CNA incentive of P20,000 each to all officers of the Corporation in 2004 was disallowed in audit	
Management should settle the Notice of Disallowance.	**Not Implemented.** Part of Observation No. 13.
7. Reimbursement of fuel consumed by personal vehicles of Members of the Board of Directors in 2004 was disallowed in audit.	
Management should settle the Notice of Disallowance.	**Not Implemented.** Part of Observation No. 13.