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The Quality of Financial Reporting of the Social Security System[1]

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This study analyzed the financial reporting practices of the biggest pension fund covering employees of the private sector in the Philippines – the Social Security System (SSS). Of particular interest in the present assessment of the SSS financial reports was the sufficiency and quality of information available in the reports for users to assess the System's financial position, performance, and cash flows. The study finds that, despite the unqualified opinion given the reports by the Commission on Audit, there are inadequacies in the reporting practices of the SSS regarding receivables, investment property, and its pension and insurance liabilities. Thus, there is insufficient quality information provided in the SSS' financial reports to enable users to assess its financial condition, including its disclosed unfunded liability of ₱1.22 trillion as of 2011. The study also presents findings comparing the performance of the SSS with the GSIS and with two government pension funds in Thailand and Singapore. It concludes with a number of policy issues relating to the pension fund system of the Philippines.

1 Introduction

Nothing is as simple as it seems. This adage is truest in government. The simplest procurement that can be undertaken in the private sector with one petty cash ticket is covered—when undertaken by a government entity—by a multiple page Congressional law, its implementing rules and regulations, and even more pages of rules and regulations of the Commission on Audit.

A ₱2,000 increase in the monthly pension of SSS retirees when the amount the great majority of them currently receive is less than half of the minimum wage seems to be plain common sense. The monthly pension is simply too small to live by so it needs to be raised. Simple. This is why President Aquino's veto of the bill that mandated this in late 2015 was met with incredulous outrage from almost all sectors. The unpopularity of President Aquino's action was highlighted by the fact that the bill was unanimously passed by the House of Representatives[2] and approved by all but one senator.

Still, it behooves all to base his/her judgment of these events on reason rather than emotion. As pointed out by Pres. Aquino, raising monthly pensions affects not just the pensioners but all members of the SSS. The proposed increase in pensions will reduce the life of the fund by 13 years (i.e., fund will be depleted by 2029), in effect risking the pensions of all future retirees in favor of the present ones[3]. SSS Management agreed with the veto, pointing out that increasing expenditures without raising contributions will jeopardize the fund. Proponents of the bill, on the other hand, say that addressing SSS' collection inefficiencies will be enough to fund the increase.

It should also be realized that, as SSS pensions are covered by a Sovereign guarantee, any change in the amount of pensions to be granted affects all taxpayers in the Philippines as well. Given the

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[1] This version as of 23 Jan 2017. The research assistance of Dazzle Dick Mercado and Toni Lei Uy for this study is gratefully acknowledged. Earlier this year, an across-the-board pension increase for SSS pensioners of ₱2,000 per month was approved by (now) Pres. Rodrigo Duterte, with ₱1,000/month effective January 2017 and another ₱1,000/month effective in 2022 "or earlier". Noting that taxpayers' money should not be used to fund the pension hike, the President also approved an increase in the monthly salary credit of the SSS from ₱16,000 to ₱20,000 as well as a contribution increase of 1.5% beginning May 2017. It is also reported that reforms to the SSS Charter will be deliberated on by Congress this year. One of the most important provisions to be reviewed is the power of the Philippine President to approve or disapprove all SSS contributions and pension adjustments.

[2] House Bill 5842 with short title, Mandating A Two Thousand Peso (₱2,000.00) Across – The Board Increase In The Monthly Pension With Corresponding Adjustment Of The Minimum Monthly Pension Under The Social Security System, was passed on third reading at the House of Representatives with 211 affirmative votes and zero negative/abstention votes.

[3] Aquino rejects SSS pension hike bill. (2016, January 15). *Rappler*. Retrieved from http://www.rappler.com

impact of the Sovereign guarantee on national finances and the credit standing of the country, it is correct to say that raising SSS pensions has inter-generational effects – it is consequential for all current and all future Filipinos. One needs only to study the very serious problems currently faced by the peoples of Greece, Brazil, Venezuela, and Puerto Rico to realize that Government spending excesses in the present impose very heavy penalties on its citizens down the road.

Not simple.

Rational decision making and public debate require that people have access to "accurate" and reliable information on the financial condition and affairs of the SSS. This is why clear and generally accepted standards of accounting and reporting are required, and why compliance by institutions such as the SSS to these standards is vital. This is the subject of this paper.

The principal objective of this study is to assess the quality of financial reporting of the Social Security System. The study also aims to present information on the condition and performance of the SSS and to compare some aspects of this with that of the Government Service Insurance System, the pension fund administrator for public sector employees, and with pension fund institutions of two other countries in the ASEAN (i.e., Thailand and Singapore). The comparison will hopefully allow readers to better appreciate the situation of the SSS and inform the necessary discussions/actions to address the ability of the SSS to provide "meaningful" social security to Filipinos working in the private sector as required by its mandate.

The paper proceeds as follows: Section 1 provides a brief description of the Social Security System (SSS). Section 2 assesses the quality of financial reporting of the SSS by checking on its compliance with Philippine Financial Reporting Standards. Section 3 discusses the financial condition and performance of the SSS and compares some aspects of these with three other pension funds', including the Government Service Insurance System (GSIS). Section 4 concludes with a number of policy issues and other areas for future study.

2 The Social Security System

The Social Security System (SSS) was created in 1954 by Republic Act 1161, more than 15 years after the creation of the Government Service Insurance System (GSIS), the pension fund administrator for employees in the public sector, in 1936. The SSS law mandated compulsory coverage of all private sector-employed individuals not exceeding 60 years of age and their employers, as well as of self-employed individuals earning at least ₱1,800 per annum. RA 1161 aimed to provide retirement, death, disability, sickness, maternity, and funeral benefits to covered employees. The coverage and benefits prescribed by RA 1161, as well as the powers of the SSS and its governing body, were significantly expanded and increased by RA 8282, which was passed in 1997.

The SSS and the GSIS manage the two biggest pension funds in the Philippines. Table 1 below presents key features and financial information of the two institutions:

Table 1. Key Features and Financial Information of the SSS and GSIS

	SSS	GSIS
Enabling Law and Year of Creation	RA 1161 (1954), as amended by RA 8282 (1997)	Commonwealth Act No. 186 (1936), as amended by Presidential Decree No. 1146 (1977) and Republic Act No. 8291 (1997)
Principal Mandate/State Policy	Promote social justice and provide meaningful protection to members and their beneficiaries against the hazards of disability, sickness, maternity, old age, death, and other contingencies resulting in loss of income or financial burden (RA 8282 Sec. 2)	Promote the efficiency and welfare of the employees of the Government of the Philippines and to replace the present pension systems established in Acts Numbered 1638, 3050, 3173, as amended (CA 186 Sec. 3)

	SSS	GSIS
Governing Body	"The SSS shall be directed and controlled by a Social Security Commission, hereinafter referred to as 'Commission', composed of the Secretary of Labor and Employment or his duly designated undersecretary, the SSS president and seven (7) appointive members, three (3) of whom shall represent the workers' group, at least one (1) of whom shall be a woman; three (3), the employees' group, at least one (1) of whom shall be a woman; and one (1), the general public whose representative shall have adequate knowledge and experience regarding social security, to be appointed by the President of the Philippines. (underscoring added) (RA 8282 Sec. 3)	"The corporate powers and functions of the GSIS shall be vested in and exercised by the Board of Trustees composed of the President and General Manager of the GSIS and eight (8) other members to be appointed by the President of the Philippines, one (1) of whom shall be either the President of the Philippine Public School Teachers Association (PPSTA) or the President of the Philippine Association of School Superintendents (PASS), another two (2) shall represent the leading organizations or associations of government employees/retirees, another four (4) from the banking, finance, investment, and insurance sectors, and one (1) recognized member of the legal profession who at the time of appointment is also a member of the GSIS." (underscoring added) (RA 8291, Sec. 42)
Social Security Benefits	Per RA 1161 1. Retirement 2. Death 3. Disability 4. Maternity 5. Sickness 6. Funeral	Per RA 8291 1. Separation 2. Retirement 3. Disability 4. Funeral benefit 5. Survivorship 6. Life Insurance
Type of Retirement Benefits Plan	Defined benefits[4]	Defined benefits
Number of Members	33.56 million (registered employee, self-employed and voluntary members as of Nov 2015)	1.5 million (active members as of 31 Dec 2015)
Number of Pensioners	1.8 million (as of November 2015)	0.4 million (as of 31 Dec 2015)
Selected Financial Information (as of or for the year ended 31 December 2015)[5]		
Total Assets	₱444.4 billion	₱960 billion
Value of Social Insurance Fund	₱402.6 billion	₱865 billion
Total Contributions (SIF)	₱130.8 billion	₱83 billion
Total Benefits Paid (SIF)	₱111.5 billion	₱85 billion
Total Operating Expenses	₱8.85 billion	₱5.8 billion

The enabling Charters of both the SSS and the GSIS define the powers of the agencies and their respective governing boards. As all members of the highest governing bodies of the two public

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[4] A defined benefit plan is a retirement plan that pays retirees a prescribed amount of benefits irrespective of the contributions made towards, and the value of, the fund from which the benefits will be drawn. The employer/fund sponsor makes itself liable for the amount of benefits it promises to pay to retiring members. It is distinguished from a defined contribution plan whereby an entity's obligation to provide retirement benefits is discharged by making agreed fixed contributions into a separate entity (retirement fund). In a defined benefits plan, the risk of poor performance of the retirement fund is borne by the employer/fund sponsor while in a defined contributions plan, this risk is borne by the retirees.

[5] Data for the SSS are from SSS Annual Report, 2015. Retrieved from https://www.sss.gov.ph/sss/Download Content?fileName=SSS%202015%20AR_FINAL.pdf. Data for the GSIS are from GSIS FS 2015. Retrieved from http://www.gsis.gov.ph/financial-statements/

pension funds are appointed by the President of the Philippines, however, the influence of the latter in how the agencies are run is unavoidable. The power of the Philippine President is even more explicit in the SSS than in the GSIS, considering that all rules and regulations that may be adopted by the SSS Commission in the pursuit of its mandate are subject to the former's approval (RA 8292 Sec. 4.1). This requirement is not as clearly spelled out in the GSIS Charter (see RA 8291 Sec. 43a and 43b). Nonetheless, changes in contributions and benefits in both funds do require the PH President's consent (RA 8292 Sec. 18 and RA 8291 Sec. 9b). As a result of the aforesaid provisions, both funds are clearly subject to significant political influence. Agency theory will predict that this kind of situation may not work to the advantage of the funds' principal stakeholders (i.e., their contributors and pensioners) in the absence of clear controls. There is at least some anecdotal evidence in both funds' history that can be argued to support this proposition.

It is important to note that retirement contributions and benefits are computed very differently by the SSS and the GSIS as prescribed by their respective charters. This is the reason why the SSS has much less funds available for more members and pensioners than the GSIS has.

The monthly contribution of a GSIS member is a fixed percentage (currently, 21%) of his/her salary - with employee and employer's share equal to 9% and 12%, respectively. The formula for computing the basic monthly pension uses the employee's average monthly compensation in his/her last three (3) years of government service.

For SSS members, on the other hand, contributions and retirement benefits are based on a schedule of varying "monthly salary credit" amounts. At the moment, the maximum monthly salary credit is at ₱16,000. This means a member with a monthly salary of ₱16,000 and another with a monthly salary of ₱50,000 pay the same amount of contributions to SSS and will receive the same retirement benefit, all other factors equal. Based on the latest SSS schedule of contributions, total monthly contributions (employee and employer's share) are around 11-14% of an employee's salary. The percentage begins to drop once one's salary exceeds ₱16,000 per month. To illustrate, a teacher earning ₱25,000 per month will pay 7% of this salary as SSS contribution, but if he/she was a GSIS member, he/she will have to contribute 21%.

3 Assessment of Financial Reporting Practices of the SSS

To assess the quality of financial reporting of the SSS, this study used compliance with Philippine Financial Reporting Standards (PFRS) as the basis. The financial statements as of and for the year ended 31 December 2014 were examined as these are the latest audited reports available in the websites of both the SSS and the Commission on Audit.

3.1 Financial Reporting Standards

Note 2.1 (a) of the SSS 2014 audited financial statements states that the reports were "prepared in accordance with Philippine Financial Reporting Standards (PFRS), **where practicable**. PFRS includes all applicable PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations used by the Financial Reporting Standards Council (FRSC)" [emphasis added] (SSS 2014, p.56). In the Audit Certificate on the said SSS report, COA Rochie J. Felices rendered an unqualified opinion with emphasis on matter[6], stating that the SSS financial statements "present fairly, in all material respects, the financial position of the Social Security System as at December 31, 2014 and its financial performance and its cash flows... **in accordance with Philippine Financial Reporting Standards** [emphasis added]" (SSS 2014, p. 51).

The insertion of the phrase "where practicable" in the compliance statement of SSS is not in accordance with PFRS, particularly Philippine Accounting Standard 1 par. 16 that states:

[6] The COA opinion drew attention to Note 19 to the financial statements on Other Current Liabilities. The COA noted that there are undistributed collections on loan amortizations and unposted contributions which render loan balances and members' accounts reported as of 31 December 2014 as inaccurate. SSS is currently working to address this matter.

> "An entity whose financial statements comply with PFRSs shall make an **explicit and unreserved** statement of such compliance in the notes. An entity shall not describe financial statements as complying with PFRSs unless they comply **with all the requirements of PFRSs**." [emphasis added]

Aside from raising questions as to what other standards can be/were used when PFRS was deemed not "practicable", the qualification in the SSS financial statements also seems to imply that compliance with PFRS can or may be unilaterally set aside by the SSS for reasons of "practicability". This is not consistent with the "unreserved" compliance which PFRS requires.

3.2 The Standard of Fair Presentation

Fair presentation, as defined in PFRS,[7] requires not only compliance with the recognition and measurement rules of assets, liabilities, income and expenses of the reporting entity in accordance with applicable PFRS, **but also provision of needed disclosures** that will enable users "to understand the impact of particular transactions, other events and conditions on the entity's financial position and performance."[8] Quoting from the standard:

> 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. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.[9]

In assessing the compliance with PFRS of the SSS financial statements, therefore, the first step is to identify the specific standards that should be used in accounting for the transactions, products, and services of the reporting entity. Also, as emphasized in the quote above, disclosure of relevant information is crucial in PFRS compliance as it is the provision of additional information (such as accounting policies followed, the supporting details of numbers presented on the face of the financial statements, assumptions made and bases of estimates used by management in the financial statements) which enables users to have a more complete and thorough understanding of the entity's financial condition and performance.

Given the SSS' mandate and activities, this study focused on compliance by the institution with the following standards: (1) IAS/PAS 26 Accounting and Reporting by Retirement Benefit Plans[10], (2) IFRS/PFRS 4 Insurance Contracts, (3) IAS/PAS 40 Investment Property, (4) IAS/PAS 39 Financial Instruments: Recognition and Measurement, and (5) IFRS/PFRS 7 Financial Instruments: Disclosures.

Specific findings as regards compliance with PFRS follow.

1. There is insufficient information provided in the financial statements for users to determine the pension liability of the SSS due to the non-disclosure of the actuarial present value of promised retirement benefits as required by PAS 26.

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[7] Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS) promulgated by the Financial Reporting Standards Council are identical to International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board and its predecessor, the International Accounting Standards Council. In this paper, PAS and IAS as well as PFRS and IFRS are interchangeably used. For example, PAS 1 para 15 is the same as IAS 1 para 15; PFRS 4 para 15 is the same as IFRS 4 para 15.

[8] PAS 1 para 15 and 17

[9] PAS 1 para 15

[10] PAS 26 para 7 explicitly excludes "government social security type arrangements" from the scope of the standard. This is likely due to the fact that IAS/IFRS have mostly focused on the financial reporting requirements of profit-oriented entities. However, there is currently no other standard that can be used to evaluate the reporting of the SSS' retirement benefits plan. Moreover, the SSS identifies no other standards that it used to prepare its financial statements other than PFRS.

PAS 26 para 17 requires that the financial statements of a defined benefit plan contain the "actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits xxx" (para. 17). This information is not provided by the SSS. Instead, SSS reports the following in Note 23 to the Financial Statements (SSS Annual Report, 2014, p. 70):

Table 2. Unfunded Liabilities and Fund Life of the SSS Social Insurance Fund

Year of Actuarial Valuation[11]	1999	2003	2007	2011 (Original)	2011 (Updated)
Unfunded Liability	Not reported	Not reported	₱748.99 billion	₱1.19 trillion	₱1.22 trillion
Year Fund Will Last	2015	2031	2039	2043	2042[12]

As explained in Note 23, Unfunded Liability is "the difference between the present value of future benefits and operating expenses vis-à-vis current assets and the present value of future contributions." Neither Unfunded Liability nor Year Fund Will Last, which are reported by the SSS, is the "present value of promised retirement benefits" required to be disclosed by PFRS.

2. Liabilities are understated while Income and Reserves are overstated due to the non-accrual of insurance liabilities of the Employees Compensation and State Insurance Fund in accordance with PFRS 4.

The financial statements of the SSS include the accounts of the Employees Compensation and State Insurance Fund (EC-SIF) which it administers as provided for by Presidential Decree No. 626. According to Note 2, the fund was established "to provide a package of benefits for public and private sector employees and their dependents in the event of work-connected contingencies such as sickness, injury, disability or death" (SSS Annual Report, 2014, p. 57).

SSS reports only ₱53,147 as liabilities of the EC-SIF as of 31 December 2014 and does not describe or disclose the accounting policy used to determine the value of this liability. Nonetheless, it is certain this amount is not the amount of insurance liabilities that the EC-SIF should report as required by PFRS 4.

PFRS 4 para 15 states:

> An insurer shall assess at each reporting date whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities... is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.

The non-recognition of insurance liabilities means that the reported income and reserves of the EC-SIF that were consolidated with the income and reserves of the SSS, are overstated.

3. There is insufficient information to assess the quality and significance of financial assets on SSS' financial position and performance due to inadequate compliance with disclosure requirements prescribed by PFRS 7. The policy of recognizing Members' Contributions as revenue upon collection is not compliant with PFRS.

[11] RA 8282 Sec. 4 (b) (2) requires the Actuary of the SSS to submit a valuation report every four (4) years or more frequently as may be necessary to determine the actuarial soundness of the reserve fund of the SSS

[12] At an interview in early November 2016, SSS Chair Atty. Amado Valdez disclosed that the SSS Fund is expected to last until 2025 if the across-the-board ₱2,000 per month pension increase is fully implemented in 2017. Reference: Ager, M. (2016, November 28). Gordon panel OKs P1000 initial SSS pension hike grant. *Inquirer.net.* Retrieved from http://newsinfo.inquirer.net/848567/gordon-panel-oks-p1000-initial-sss-pension-hike-grant)

Financial assets comprise 94% of the total assets of SSS on 31 December 2014. This asset class is the main source for the payment of SSS benefits; thus, the quality and value of these assets are of great importance to SSS members and all individuals needing to assess SSS' financial condition and performance.

Based on the 2014, 2013 and 2012 Statements of Financial Position of the SSS, the entity has the following investments in financial assets (amounts in pesos):

Table 3. SSS Financial Assets as of Years Ended

	31 December 2014	31 December 2013	31 December 2012
Cash and cash equivalents	14,083,905,111	17,949,859,943	16,151,334,531
Held-to-maturity investments	17,133,909,303	11,718,489,366	731,066,508
Held-for-trading financial assets	3,926,486,365	4,320,944,049	2,637,786,634
Loans & receivables	698,177,808	987,071,510	6,935,537,428
Other receivables	10,178,110,135	6,838,058,869	
Non-current financial assets	354,840,305,710	317,547,179,666	312,925,169,986
Total Financial Assets	400,860,894,432	359,361,603,403	339,380,895,087
Total Assets	427,164,923,242	384,633,278,332	362,805,054,982
FA as % of Total Assets	94%	93%	94%

Non-current financial assets, which constitute the bulk of the SSS' Total Assets, are mostly in the form of Available-for-Sale and Held-to-Maturity Instruments, as shown in Table 3A below.

Table 3a. Breakdown of Non-Current Financial Assets as of 31 December

	2014		2013	
Available for sale financial assets	106,434,270,333	30%	96,359,059,054	30%
Held-to-maturity investments	173,992,829,497	49%	147,619,118,062	46%
Member loans	65,925,575,783	19%	64,016,332,962	20%
Accumulated impairment loss	(4,699,809,548)	-1%	(4,447,211,816)	-1%
Loan to National Home Mortgage Finance Corporation	10,491,014,866	3%	10,369,163,018	3%
Accumulated impairment loss	(1,025,498,216)	0%	(985,090,243)	0%
Housing loans	2,942,552,434	1%	4,249,848,356	1%
Accumulated impairment loss	(226,736,478)	0%	(638,040,381)	0%
Commercial and industrial loans	416,802,271	0%	409,097,786	0%
Accumulated impairment loss	(63,817,391)	0%	(63,827,453)	0%
Program MADE	17,219,220	0%	17,219,220	0%
Accumulated impairment loss	(17,219,219)	0%	(17,219,219)	0%
Loan to government agencies	21,657,436	0%	49,462,389	0%
Sales contract receivable	662,212,666	0%	641,815,874	0%
Accumulated impairment loss	(30,747,944)	0%	(32,547,943)	0%
Total Noncurrent Financial Assets	354,840,305,710	100%	317,547,179,666	100%

In Note 29 of the 2014 Financial Statements describing the financial risk management policies and practices of the SSS, however, analysis is provided only for ₱314.4 billion (78.4%) of the financial assets portfolio of the Agency, as can be seen below:

Table 4. Aging Schedule of SSS Financial Assets per Note 29 of the 2014 Financial Statements (SSS Annual Report, 2014, p. 74)

	2014								
		Past due but not impaired (Age in months)							
	Neither past due nor impaired	3-12	13-36	37-48	49-60	Over 60	Expired	Impaired	Total
					(In Millions)				
Held-for-trading financial assets	3,926								3,926
Available-for-sale financial assets	106,434							1,292	107,726
Held-to-maturity investments									
Short-term money placements	7,169								7,169
Corporate notes and bonds	24,875								24,875
Government notes and bonds	159,082								159,082
Loans and receivable									
National Home Mortgage Finance Corporation	9,947							1,025	10,972
Commercial and industrial loans	513					2	12	64	591
Program MADE							0	17	17
Other government agencies	44								44
	311,990					**2**	**12**	**2,398**	**314,402**

This is in violation of PFRS 7 para 6 that requires that information provided by reporting entities should be sufficient to permit reconciliation to the line items presented in the Statement of Financial Position (SFP). The list and amounts of Financial Assets on the Statement of Financial Position (shown in Table 3) do not completely reconcile with the analysis shown in Table 4 which is in the Notes to the Financial Statements. There is no information provided on the credit risk for around ₱72 billion of financial assets in SSS' SFP[13] or on the market risk exposure of the SSS' financial assets, including available-for-sale financial assets amounting to ₱106.4 billion (24.9% of SSS' total assets as of December 31, 2014).

This study also attempted to find in the SSS' financial statements any information on ₱325 billion of receivables that a Congressman claimed SSS was not able to collect.[14] There is none. Per Note 2.11 of SSS' financial statements, Members' Contribution is recognized as revenue upon collection (SSS 2014, p. 61). The acceptability of this policy is questionable given that financial information is required by PFRS to be reported on an accrual rather than cash basis.[15] The policy implies that SSS does not report, as receivables and as income, members' contributions due as of the end of the year, thereby understating total assets and income for the year. Moreover, the consequence of this policy is that users of SSS' financial statements are unable to determine the collection efficiency of the Agency – an indicator that is clearly important in evaluating the performance of SSS Management.

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[13] Total financial assets in the SFP of ₱400.86 billion (Table 3) less Financial Assets in Note 29 of ₱314.4 billion (Table 4) and cash and cash equivalents of ₱14 billion

[14] Rosario, B. (2016, January 25). Make public audited computation of collections, Colmenares Urges SSS. *Manila Bulletin*. Retrieved from http://www.mb.com.ph/make-public-audited-computation-of-collections-colmenares-urges-sss/#YhAHzsTed4PXT3wa.99

[15] IASB (2012). Conceptual framework for financial reporting 2011.

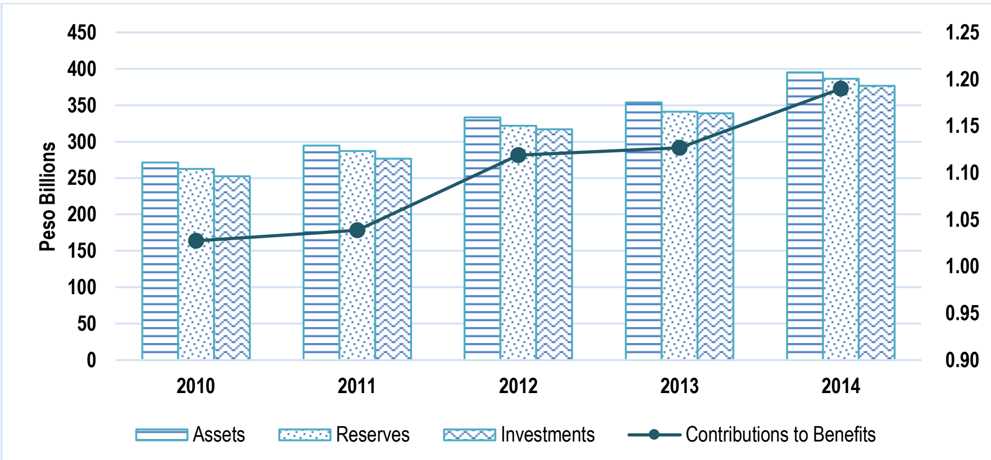
4. There are insufficient disclosures on Investment Property following PAS 40.

PAS 40 para 75 (d) requires disclosure of the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market date. This information is not provided in the SSS financial statements.

4 Financial Condition and Performance of the SSS

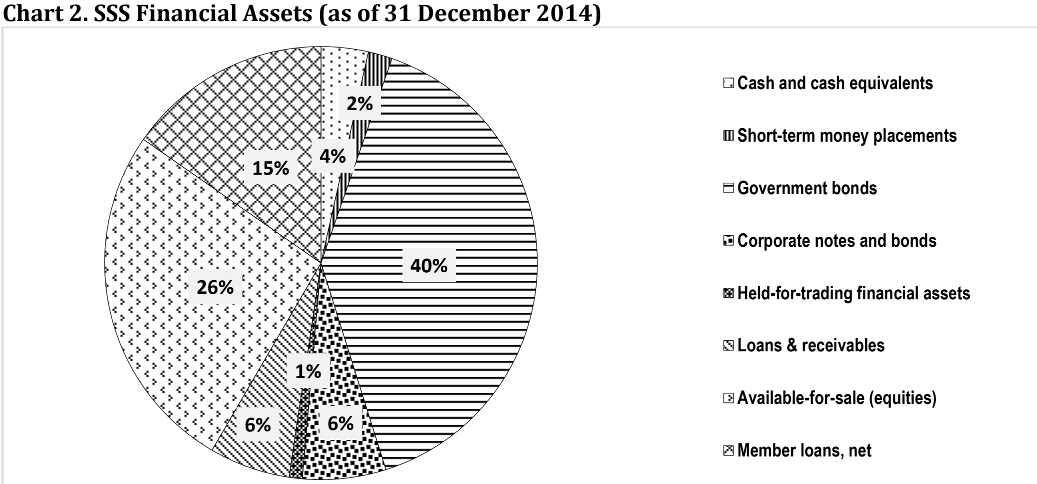
The period 2010 to 2014 saw the SSS improve in financial strength, with its assets, reserves and investments growing at a compound annual rate of 10% to 11%. The contributions-to-benefits ratio showed marked improvement as well, increasing from 1.03 in 2010 to 1.19 in 2014 (Chart 1).

Chart 1. SSS Resources and Investments



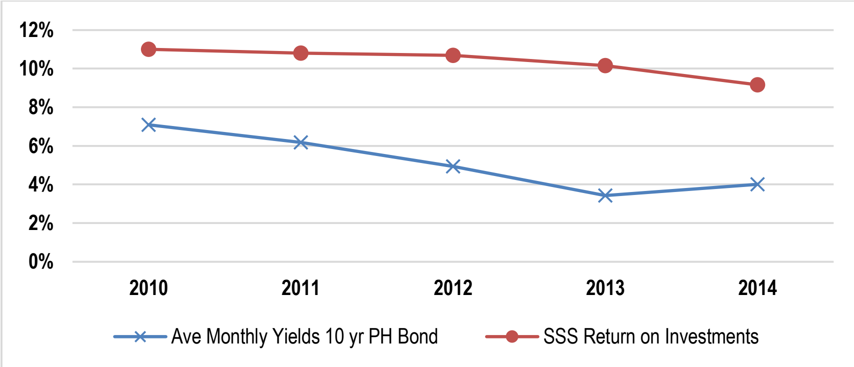
Financial assets comprised 94% of total assets as of 31 December 2014 and has a breakdown composed mostly of government bonds (40%), equities (26%) and member loans (15%) (Chart 2).

Chart 2. SSS Financial Assets (as of 31 December 2014)



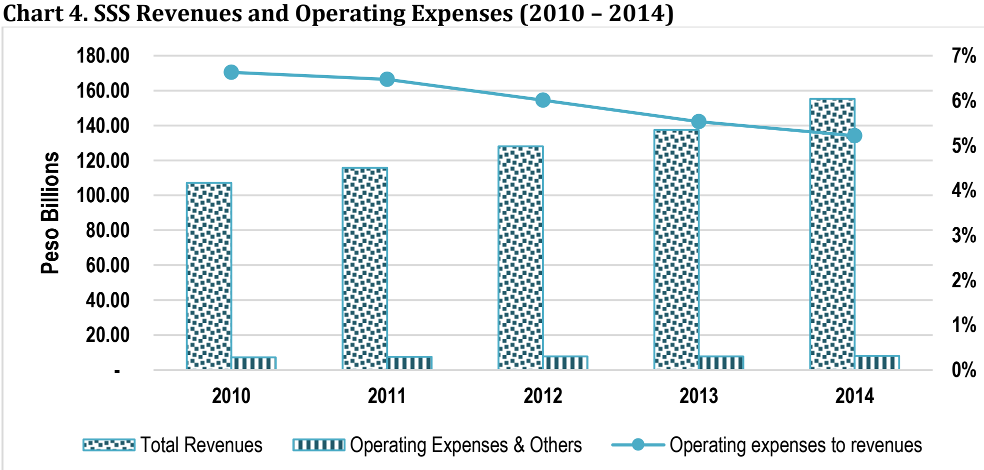
Return on investments had slightly fallen over the 5-year period, although SSS' performance is still favorable if the general fall in interest rates over this period is considered (Chart 3).

Chart 3. Return on SSS Investments (2010 – 2014)



Efforts to control costs are also evident in the data. While revenues grew at a compound annual rate of 10% from 2010 to 2014, operating expenses remained flat. Thus, as a percentage of revenues, operating expenses fell from 7 to 5 (Chart 4). The SSS is allowed by its charter to incur up to 12% of revenues for its operating expenses.

Chart 4. SSS Revenues and Operating Expenses (2010 – 2014)



More than above, what would probably be of interest to members is to know whether their forced monthly contributions to the SSS provide them with a fair rate of return. This is discussed next.

4.1 Returns on Monthly Contributions: SSS and GSIS

The study developed a simple model to determine the internal rate of return assuming two employees that start out at the same age with a monthly salary of ~₱28 thousand[16]. Each enjoys an annual 5% salary increase and unfailingly pays his/her monthly contribution (along with the employer's share) to the SSS or GSIS up to the compulsory retirement age (in the public sector) of 65 years old. The two employees retire and receive their monthly pensions for five years; after which their primary beneficiary is able to receive death or survivorship benefits for five more years.

If only retirement, death, and survivorship/death benefits are considered, the returns on the total monthly contributions (employee and employer share) for SSS and GSIS members are 1.4% and 3% respectively. If no salary increase is assumed, the return of an SSS member remains at 1.4% but it becomes 0.3394% for the GSIS member.[17] It appears the much higher contributions of the GSIS

[16] This is the starting salary of an Instructor IV at UP Diliman.

[17] Assuming the GSIS retiree chooses the option of an 18-month cash payment combined with a monthly pension immediately after retirement rather than the option of a 60-month lump sum but no monthly pension until after five years. The latter option has an even lower return when there is no assumed salary increase.

member are an advantage if his/her salary increases in the last three years of government service, as this becomes the basis for the monthly pensions he/she will receive.

The model assumes no adjustments for inflation aside from the annual salary increase. SSS and GSIS contributions and benefits are set at nominal amounts and do not automatically adjust for inflation. It is difficult to incorporate in the model changes that may be made to contributions and benefits during the period of employment to consider inflation as these are policy (even political) decisions. The results show the necessity of making these periodic adjustments; otherwise, the SSS and GSIS members' contributions have a negative real financial return.

4.2 Results of a Benchmarking Exercise[18]

For a better appreciation of the performance of the SSS, further comparison with GSIS as well as with two (2) other pension funds in Southeast Asia was undertaken. Table 5 compares the four (4) funds on some basic facts:

Table 5. Basic Information on SSS and Three Other Pension Funds

	Social Security System	Government Service Insurance System	Thai Government Pension Fund	Singapore Central Provident Fund
Total Assets as of 31 Dec 2014	₱427.2 billion	₱907.1 billion	Thai Baht 710,488,138,930 (approximately P952 billion)[19]	S$278,112,997,000 (approximately P9,691 billion)[20]
Total Membership	33.56 million (registered employee, self-employed and voluntary members as of Nov 2015)	1.5 million (active members as of 31 Dec 2015)	1,179,668 (members as of Jul 2012)[21]	3,593,000 (membership as of Dec 2014)[22]
Type of Retirement Plan	Defined Benefits	Defined Benefits	Defined Contribution	Defined Contribution

4.3 Operating Efficiency

As regards operating efficiency, the study used operating expenses to total revenues, and operating expenses per member and pensioner. The results of the calculations are shown below:

Table 6.

	Social Security System	Government Service Insurance System	Thai Government Pension Fund[23]	Singapore Central Provident Fund
Operating Expenses to Total Revenues	5.23%	2.24%	7%	0.62%
Operating Expenses per Member and Pensioner (in Phil peso)[24]	229.63	2,765.19	1,693.57	2,401.86

While both charters of the SSS and GSIS prescribe an expense ratio ceiling that is a percentage of total revenues (including members' contributions)[25], a fairer comparison of operating efficiency was

[18] Financial information used in this section is as of and for the year ended 31 Dec 2014 unless otherwise indicated.
[19] At peso:baht exchange of 1.34:1
[20] At peso:S$ exchange of 34.85:1
[21] https://www.gpf.or.th/eng2012/member_profile.asp
[22] https://www.cpf.gov.sg/Members/AboutUs/about-us-info/cpf-overview
[23] Unlike the SSS, GSIS and the Singapore Central Provident Fund, the Thai Government Pension Fund does not follow International Accounting Standards.
[24] For Thai and Singapore pension funds, ratios are based on number of members only. Number of pensioners is not available.

obtained by computing expenses per member and pensioner. Using this metric, the SSS appears to be the most operationally efficient in the group. Of course, the quality of service delivery must be considered alongside this indicator to ensure that lower costs do not also mean much poorer service to the SSS members. This measure is also better determined using active members rather than total registered members as denominator, as the sizes of these two groups are vastly different for the SSS.[26]

4.4 Investment Returns, Fund Viability and Sustainability

The Return on Assets and Contributions to Benefits Ratio were used to evaluate these aspects of performance. The results are in Table 7, 7a and 7b, and Table 8. For Fund Sustainability, data on assets as a percentage of gross domestic product are presented in Table 9.

Table 7.

	Social Security System	Government Service Insurance System	Thai Government Pension Fund[27]	Singapore Central Provident Fund[28]
Reporting Currency	PH Peso	PH Peso	Thai Baht	Sing Dollar
Total Investment and Other Income (in billions, reporting currency)	34.5	147.2	22.4	10.5
Total Assets (in billions, reporting currency)	427.2	907.1	710.5	278.1
Return on Assets (Investment and Other Income/Total Assets)	8.08%	16.22%	3.15%	3.78%

The results reported above were based on the figures as reported in the financial statements of the funds as of and for the year ended 2014 and did not consider differences in the accounting policies used.

Tables 7a and 7b focus on the SSS and the GSIS, showing the breakdown of total assets and investment income for the two funds for 2015 and 2014.

Table 7a. SSS Assets 2015 and 2014: Composition, Income and Returns (all figures in PH Peso, except %)

BREAKDOWN OF ASSETS	2015		2014	
Cash and Cash Equivalents	19,112,368,217	4%	14,083,905,111	3%
Held-to-Maturity Notes & Bonds	207,577,195,538	47%	191,126,738,800	45%
Held-for-Trading Financial Assets	4,295,367,446	1%	3,926,486,365	1%
Available-for-Sale	95,178,632,224	21%	106,434,270,333	25%
Member Loans, net of impairment	66,501,447,002	15%	61,225,766,235	14%
Loans & Receivables	13,115,232,725	3%	13,885,617,453	3%
Investment Property	19,488,937,709	4%	17,956,117,270	4%
Other Assets, including non-interest bearing receivables	19,130,113,590	4%	18,526,021,675	4%
Total Assets	444,399,294,451	100%	427,164,923,242	100%

[25] RA 8282 Sec. 25 allows the SSS to disburse a maximum of 12% of total yearly contributions plus 3% of other revenues for administrative and operational expenses. For the GSIS, a maximum of 12% of the "yearly revenues from all sources" is allowed (RA 8291 Sec. 35).
[26] According to reports, SSS has around 12 million "actively-paying" members.
[27] Data from Government Pension Fund and Subsidiaries Auditor's Report 2014. Retrieved from https://www.gpf.or.th/eng2012/about_financstat.asp
[28] Data from Central Provident Fund Board Annual Report 2014. Retrieved from https://www.cpf.gov.sg/Members/AboutUs/about-us-info/annual-report

INVESTMENT AND OTHER INCOME				
	2015		**2014**	
Income from Held-for-Trading Financial Assets	(962,419,630)	-3%	400,437,389	1%
Income from Available-for-Sale Financial Assets	9,025,510,574	31%	14,308,724,068	41%
Income from HTM Investments	12,820,524,164	43%	12,170,391,794	35%
Income from Loans and Receivables	4,924,727,466	17%	4,813,047,202	14%
Income from Investment Property	1,956,778,073	7%	1,272,312,726	4%
Other Income	1,721,746,018	6%	1,565,714,318	5%
	29,486,866,665	100%	34,530,627,497	100%
Return on Assets	6.64%		8.08%	

Source of data: SSS Financial Statements[29]

Table 7b. GSIS Assets 2015 and 2014: Composition, Income and Returns (all figures in PH Peso, except %)

BREAKDOWN OF ASSETS				
	2015		**2014**	
Cash and Cash Equivalents	39,473,065,605	4%	44,949,093,550	5%
Member Loans and Receivable	244,983,635,804	26%	224,704,436,628	25%
ROP Notes & Bonds	350,326,074,671	36%	368,453,907,737	41%
GSIS Equity Investments	126,434,551,364	13%	113,262,007,390	12%
Corporate Bonds, Globally Peso Notes and Externally-Managed Funds	80,110,316,332	8%	72,089,033,295	8%
Investment Property	60,678,620,031	6%	32,018,684,089	4%
Other Receivables, including Premiums Receivable	45,036,359,974	5%	51,128,957,747	6%
Other Assets	13,106,011,516	1%	484,949,427	0%
Total Assets	960,148,635,297	100%	907,091,069,863	100%

INVESTMENT AND OTHER INCOME				
	2015		**2014**	
Revenue from Loans	22,307,068,085	43%	21,261,689,935	14%
Revenue from Financial Assets	(2,512,216,239)	-5%	124,450,310,673	85%
Revenue from Investment Property	28,669,500,163	55%	2,854,069,245	2%
Other revenues	3,784,571,273	7%	(1,412,704,432)	-1%
	52,248,923,282	100%	147,153,365,421	100%
Return on Assets	5.44%		16.22%	

Source of data: GSIS Financial Statements[30]

The composition of the assets of both pension funds is very similar as each has 80% to 86% of the total in the following investments: government notes and bonds, equities and managed funds, and member loans. The GSIS has a slightly bigger percentage of its assets in loans to members (26% versus 15% for the SSS). Financial reporting differences make it difficult to make straightforward comparisons of investment income, however. The GSIS has 58% of its assets in Fair Value Through Profit or Loss financial assets. As such, the GSIS reports, as part of its income, the fair value changes of its financial asset investments. The SSS, on the other hand, reports the bulk of its financial assets

[29] SSS Annual Report 2014 and 2015. Retrieved from https://www.sss.gov.ph/sss/appmanager/pages.jsp?page=annualreport

[30] GSIS FS 2015 and GSIS FS 2014. Retrieved from http://www.gsis.gov.ph/financial-statements/

as Held-to-Maturity or Loans and Receivables; thus, the private sector fund ignores fair value changes in these assets when it reports income. The difference in financial reporting policy reveals differences in investment management policies and practices between the two institutions, with the GSIS apparently choosing to be a more active and aggressive investor. The reporting policy explains the significantly higher ROA of the GSIS in 2014 versus that of the SSS (16.22% vs 8.08%). The policy also comes with a higher risk of income volatility, however, as evidenced by the reversal in GSIS' income performance the following year. In 2015, revenue from GSIS' financial assets shrunk by P127 billion compared with 2014, partially due to a ₱34 billion valuation loss in 2015 vis-à-vis a P79.3 billion valuation gain in 2014. If the GSIS had not reported the valuation increase of its investment property as part of its 2015 income, its return on assets in that year would only have been 2.5%.

Table 8.

	Social Security System	Government Service Insurance System	Thai Government Pension Fund	Singapore Central Provident Fund
Contributions to Benefits Ratio	1.19	0.95	12.77	1.61

For the Contributions to Benefits ratio, the GSIS appeared to be the "worst performer" among the four funds surveyed. This is likely because of the effects of the salary increase granted to government employees which was implemented in tranches from 2008 to 2012. A previous study by this author on the GSIS documented a declining trend in the Contributions to Benefits Ratio beginning 2010.[31]

The Thai and Singapore pension funds surveyed by this study did not report fund life. The sustainability of a pension fund is affected by several factors, including the demographics of the covered population, retirement policies, contribution rates and benefit-ratios, and investment performance. For an appreciation of how the Philippine pension funds compare with those of other countries on at least a partial aspect of fund sustainability, data on pension assets as a percentage of a country's gross domestic product (GDP) are presented in Table 9. This information was gathered and reported by the Organization for Economic Cooperation and Development (OECD) for its 35 member-countries and for a sample of 33 non-OECD countries.

Table 9. Pension Assets as Percentage of Country GDP (2015)[32]

Hong Kong, China	37.1	Former Yugoslav Republic of Macedonia	7.41
Malta	35.6	Thailand	6.58
El Salvador	33.0	Russia	5.96
Jamaica	24.2	Lithuania	5.87
Croatia	23.6	Nigeria	5.57
Uruguay	21.4	Mauritius	4.25
Kosovo	20.6	Romania	3.65
Colombia	20.4	Zambia	3.35
Peru	20.3	Egypt	1.77
Costa Rica	17.2	Indonesia	1.73
Kenya	13.5	China (People's Republic of)	1.39
Brazil	11.6	Panama	0.82
Dominican Republic	11.1	India	0.79
Bulgaria	10.9	Serbia	0.73
Maldives	9.9	Armenia	0.63
Malawi	9.6	Pakistan	0.06
Philippines (SSS and GSIS)	**9.5**	Argentina	-
		Average, 33 non-OECD countries, excl PH (data on PH not included in OECD statistics)	11.2
		Average, 34 OECD countries (no data for Japan)	37.37

Source: http://www.oecd.org, except for data on the Philippines that this study computed

[31] Government salaries were adjusted again this year. Thus, the decline in the GSIS' contributions to benefits ratio in the near term is expected to continue.

[32] OECD, Pension Markets in Focus, 2016 edition. Retrieved from http://www.oecd.org/finance/private-pensions/globalpensionstatistics.htm

While the Philippines is below the average as far as the above metric is concerned, the impact on sustainability is mitigated by the country's relatively younger population vis-à-vis most countries.

5 Concluding Remarks

This study found significant instances of non-compliance with financial reporting standards in the review of the 2014 financial statements of the Social Security System. The non-recognition of insurance liabilities[33] and policy of recognizing Membership Contributions as revenue only upon collection are the most important violations noted. Consequently, the assets, liabilities, capital, revenues, and expenses of the SSS for 2014 are not fairly presented in its financial reports in accordance with Philippine Financial Reporting Standards, contrary to the opinion rendered by the Commission on Audit.

Moreover, disclosures on the SSS' financial assets are not sufficient to enable users to assess the impact of these investments on the entity's financial condition and performance as well as to evaluate the effectiveness of the stewardship of SSS' resources. Information on premiums due and collectible as of the end of the year amounts is not available; thus, the entity's collection efficiency cannot be determined. This author supports the call for more disclosure on and audit of SSS' collection efforts.[34] Compliance with reporting rules and disclosures on SSS' pension liability and obligations must also be enforced to enable a rational and informed assessment of the fund's sustainability and measures to improve it.

There is marked improvement in the financial condition and performance of the SSS in recent years. Assets and income are growing healthily and the contributions to benefits ratio is rising. These financial gains have not been obtained by sacrificing service delivery, as there appears to be improvement in this aspect as well.

All the above successes, however, are for naught if SSS is unable to provide "meaningful" protection to its members as is its principal mandate. This study documented the dismal financial returns realized by SSS members on their contributions if benefits are not periodically adjusted for the effects of inflation. Providing returns that at the very least are above the inflation rate is the minimum that members should expect to receive from the SSS. To this end, SSS should continue to improve its prudent management of SSS' resources and control its operating costs. Costs should align more with the services the institution provides and the size of the membership it serves rather than with revenues. Certainly, costs should not be allowed to increase when membership contributions increase, regardless of what SSS is authorized to spend following its charter.

Still on the issue of meaningful protection, it was acknowledged that the SSS pension system, given its low contribution rate and monthly salary credit cap, was not designed to be the sole means of financial support for retired employees from the private sector. Many people do not realize this, and it is Government's responsibility to consider and implement additional measures that will encourage (even mandate) its citizenry to save more for retirement during their productive years. The Philippines was blessed with a relatively young population and this has given the country more time to reform and strengthen its social security mechanisms. Further study towards this end should be undertaken.

[33] Also a finding for the GSIS based on a previous study by this author

[34] Rosario, B. (2016, Jan 25). Make Public Audited Computation of Collections, Colmenares Urges SSS. Manila Bulletin

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