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Financial Condition and Reporting Practices of the GSIS*

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The objectives of this paper are three-fold: first, to assess the financial condition of the Government Service Insurance System (GSIS) post SSL-3 (the law which authorized significant government salary hikes from 2009 to 2012); second, to determine the compliance by the institution with the requirements of Philippine Financial Reporting Standards (PFRS); and third, to provide a current estimate of the returns GSIS members earn based on their expected pension benefits. After an evaluation of the 2005 to 2012 financial statements of the GSIS, the study finds that, as expected, SSL3 has started to adversely affect the GSIS' finances. This is evidenced by the increasing gap between the institution's actuarial value of social insurance liabilities and financial reserves and its declining contributions-to-benefits ratio. Despite an unqualified audit opinion, the study also finds material non-compliance in the reporting of the fund's retirement and insurance liabilities in 2012. This results in an overstatement of GSIS 2012 net worth by almost P19 billion and an understatement of liabilities by the same amount. The effect on the entity's profit and loss for the year is undeterminable without additional data. Finally, excluding the value of the insurance component of their membership benefits, government employees appear to earn less than the risk-free long-term rate of return on their monthly contributions. However, based on a comparison with a roughly similar pension product offered by a private insurer, members currently earn a higher return with the GSIS and so are still better off putting their money in GSIS for their pension needs.

1 Introduction

The interest in this study was triggered by a happy event for government employees. On July 28, 2008, the Philippine Congress passed Joint Resolution 4 authorizing the President to revise the salary levels prescribed in RA 6758 or the Salary Standardization Law. Over the next four years, most government employees received salary increases that ranged from 34% to 69%.

The salary adjustments (or SSL3) were an even bigger blessing to government employees close to retirement. Retirement benefits in government are based on the average monthly compensation in the last three years of one's employment. Since the last tranche of the salary increases was granted sometime in the middle of 2012, public servants who are due to retire from late 2012 onwards will be the beneficiaries of pension benefits that would have significantly increased due to SSL3.

The higher pension benefits caused by SSL3 cannot but impact negatively on the financial condition of the Government Service Insurance System, the institution that implements the laws that govern social security and insurance benefits for all government employees. Contributions of the imminently retiring employees were made when their salaries were much lower, and yet the benefits they will be paid will be based on their latest, significantly higher, salaries. This expected performance dip is expected to correct through time, with continuing members effectively subsidizing the retired and exiting members. Nonetheless, the extent of the impact of SSL3 on the financial health of the GSIS is of important concern to all remaining government employees and to the National Government, which by law is the guarantor of all of the GSIS' obligations to its members.

A prerequisite to a reliable assessment of the financial health of the GSIS, however, are financial statements that fairly present its financial condition, performance, and cash flows. Fair presentation follows from compliance by the institution with the relevant Philippine Financial Reporting Standards (PFRS). This study thus also aims to determine whether or not the financial statements of the GSIS are fully compliant with PFRS.

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* Government Service Insurance System

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Finally, this study intends to find out whether GSIS members earn a "fair" rate of return on their mandated pension contributions. While social security is an important public issue, it is far from settled whether a government-sponsored institution should undertake this function or not. At the moment, Philippine government employees contribute a much higher proportion of their monthly salary for their pension benefits than their private counterparts do. Whether members are fairly compensated for their forced savings or not is, thus, an important question to answer. The present study attempts to do this by estimating the returns GSIS members earn from their monthly contributions and by comparing this return to the risk-free rate as well as to the return from a roughly similar pension product offered by a private insurer.

The GSIS is one of two government financial institutions with a social security mandate, the other being the Social Security System (SSS), which takes care of the self-employed and private sector employees. The SSS is the subject of another study by this author.

2 Review of Literature and Significance of the Study

Pension systems in various parts of the world have been subject to much study given the important role these play in social security and protection. The studies on these systems in developing economies like the Philippines generally found the need for reforms to improve the pension systems' governance, sustainability, and investment policies and management (see Organisation for Economic Co-operation and Development, 2009; Asher, 2000; Holzmann, Mac Arthur, & Sin, 2000). A notable study on the two giant pension systems in the Philippines—the Government Service Insurance System (GSIS) covering most government employees and the Social Security System (SSS) that provides coverage for workers in the private sector—is that of Manasan (2009). It investigated the financial condition of the GSIS and the SSS using the contribution-to-benefits ratio and the actuarial life of the reserve fund. The study documented a decline in the contributions-to-benefits ratio for the GSIS from 2.05 in 2000 to 1.26 in 2007 and found that the actuarial life of the GSIS fund as of end-2007 was much higher at 48 years than that of the SSS at 29 years.

The present paper expects to contribute to the discussion by focusing on financial reporting as an element of the governance mechanism of pension funds, particularly in this case, the GSIS. This study also appears to be the first attempt to look at the GSIS's finances after the significant hikes in government salaries implemented from 2009 to 2012. Moreover, while replacement rate has been found to be higher for the GSIS than for many other pension systems, it is still important to know, from a finance perspective, whether the value of pension benefits recovers at least the opportunity cost of money for GSIS members.

The paper proceeds as follows: Section 3 gives an overview of the functions of the GSIS and its social insurance function, focusing on its retirement benefit program. Section 4 discusses the institution's financial reporting practices using the financial statements from 2005 to 2012 obtained from the GSIS website and makes a determination of whether or not there was compliance with the relevant reporting standards and rules. Section 5 presents a discussion on the financial health of the GSIS and the estimated returns of a GSIS member's contributions. Section 6 concludes with some policy issues and identifies areas for further investigation.

3 The Government Service Insurance System

3.1 History, Administration, Mandate

Commonwealth Act No. 186 created the GSIS in 1936 to implement the laws that govern the social security and insurance benefits of all government employees. CA 186 consolidated all the then existing pension funds created by previous laws for government employees in the GSIS. Management and governance of the GSIS was entrusted to a Board of Trustees consisting of a General Manager and seven others, all of whom were to be appointed by the President of the Republic of the Philippines. Then as in now, those who sit in the GSIS Board as representatives of government employees (or who are actual members of the GSIS) are a minority. In CA 186, only three of the eight were to come from government employee organizations or associations. In the latest amendment to the GSIS charter (RA 8291), this has been increased to four, but the total number of board members was also increased to nine. The other four seats are allocated to members of the banking, finance, investment and insurance sectors. The remaining seat is for the GSIS President and General Manager who is not required to be a GSIS member upon his appointment.

Various laws are the bases of the GSIS' mandate, authority, and functions.

- Republic Act No. 656 (1951) and Presidential Decree No. 626 (1975) mandated the GSIS to administer the Employees Compensation and State Insurance Fund and the General Property Insurance Fund, respectively
- Presidential Decree No. 1146 (1977) and Republic Act No. 8291 (1997) amended CA 186 and enhanced the social security coverage of the GSIS
- Republic Act No. 10149 (2011) identifies the GSIS as a government-owned or -controlled corporation (GOCC), particularly a government financial institution (GFI), and prescribes mechanisms to strengthen the governance of all GOCCs

Under Article IX (D) of the Philippine Constitution, the Commission on Audit has exclusive authority to examine and audit the accounts of all government entities, including GOCCs, and submit to the President and Congress an annual report on the financial condition and operation of each. The Constitution also gives the COA the exclusive authority to promulgate the accounting rules and regulations for government entities.

3.2 The Social Security Functions of the GSIS

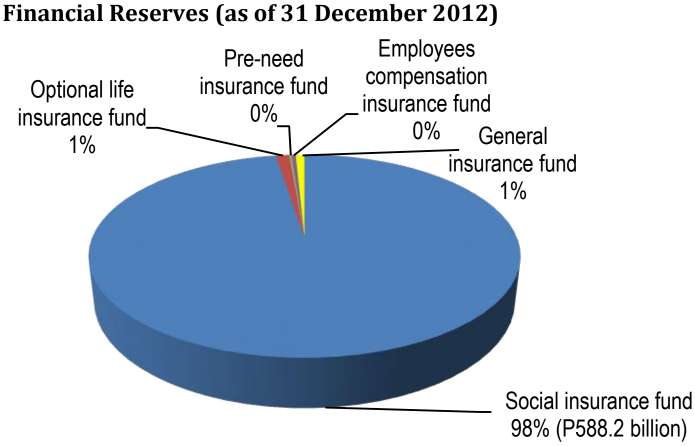
From the very beginning, membership of most government employees in the GSIS was made compulsory[2]. The amounts of mandatory contributions (employees' and employers' shares) of and benefits to be received by GSIS members were, and continue to be, fixed by law.

Based on RA 8291, GSIS members enjoy the following social security benefits:

1. Separation
2. Retirement
3. Permanent disability benefits
4. Funeral benefit
5. Life Insurance
6. Optional insurance – life, health, hospitalization, education, memorial plans

The law also prescribes that all contributions of GSIS members from which the benefits for items 1 to 5 above are to be paid, together with earnings and accruals, are to go to the GSIS Social Insurance Fund (SIF). The GSIS is required to manage this fund separately from the other funds it was required to administer by other laws. As can be seen in Chart 1 below, the Social Insurance Fund is the biggest fund managed by the GSIS.

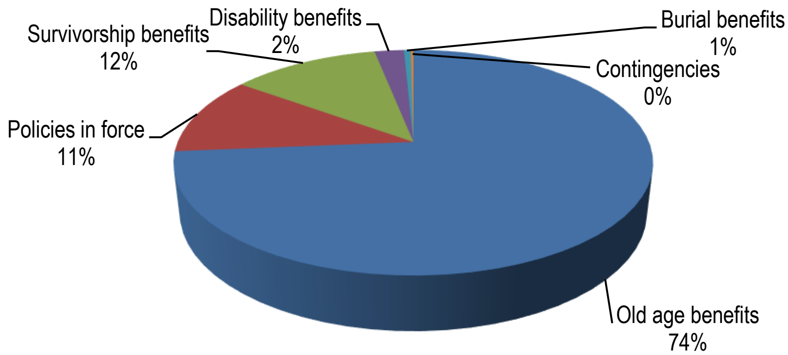
Chart 1. GSIS Financial Reserves (as of 31 December 2012)



[2] Membership in the GSIS is not compulsory for members of the Armed Forces of the Philippines and the Philippine National Police. GSIS coverage is also limited to life insurance for members of the judiciary and the Constitutional Commissions.

The Social Insurance Fund (SIF) is broken down based on the benefits to be paid out from it. Chart 2 shows the SIF break down as of 31 December 2012.

Chart 2. GSIS Social Insurance Fund (as of 31 December 2012)



GSIS members currently contribute 21% of their monthly compensation (9% employee's share + 12% employer's share) to the SIF. Four percent of the 21% go towards the life insurance coverage of the member; the rest are for the employee's retirement benefits.

Social insurance contributions and payments constitute the biggest source of revenues and expenses of the GSIS, as can be seen in Charts 3 and 4 below.

Chart 3. CY 2012 Revenues of the GSIS

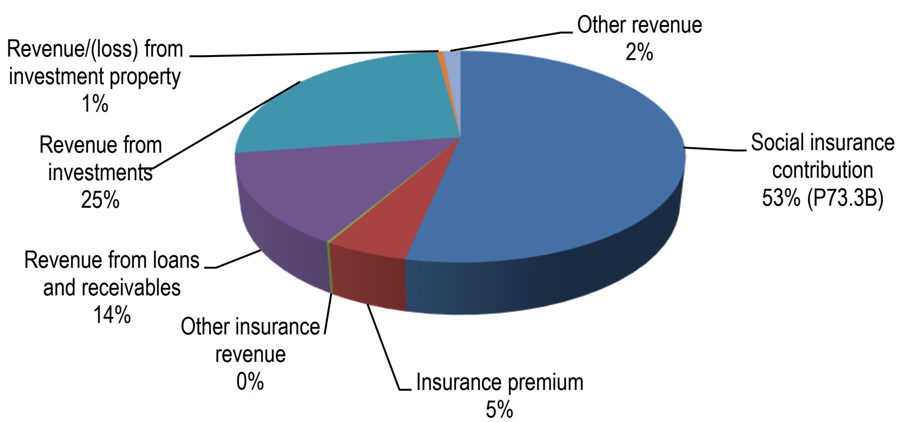
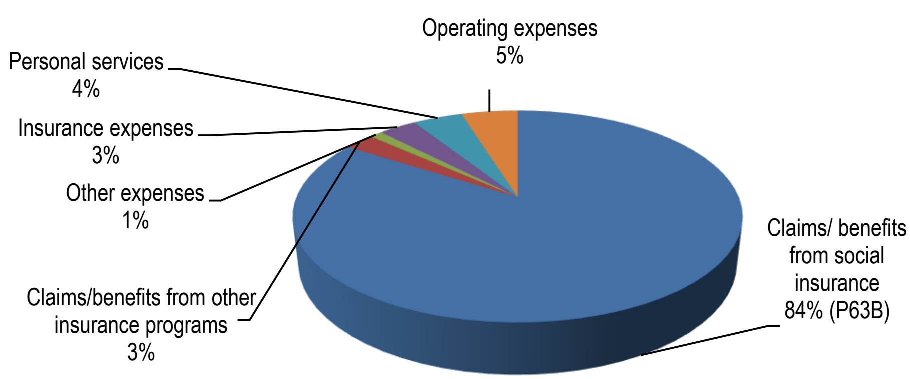


Chart 4. CY 2012 Expenses of the GSIS



4 Financial Reporting Practices of the GSIS

4.1 Reporting Standards

Note 2.1 (a) of the GSIS 2012 audited financial statements states that the reports were "prepared in compliance with Philippine Financial Reporting Standards (PFRS) issued by the Financial Reporting Standards Council (FRSC)" (GSIS 2012, p.7). In the Audit Certificate on the said GSIS report, COA Auditor J. Moreno rendered an unqualified opinion, stating that the GSIS financial statements "present fairly, in all material respects, the financial position of the GSIS and its subsidiary as at December 31, 2012 and its financial performance and its cash flows... *in accordance with Philippine Financial Reporting Standards* [emphasis added]" (Commission on Audit, 2013, p. 1). This study thus uses the standards and requirements of PFRS in assessing the quality of financial reporting of the GSIS.

4.2 The Standard of Fair Presentation

Fair presentation, as defined in PFRS,[3] 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 [emphasis added] that will enable users "to understand the impact of particular transactions, other events and conditions on the entity's financial position and performance."[4] 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.[5]

In assessing the compliance with PFRS of the GSIS's 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 that the GSIS's major functions are the management of the retirement benefits fund of government employees and the offering of insurance services to its members and other government entities, the standards that govern the entity's reporting practices are determined to include (1) IAS/PAS 26 Accounting and Reporting by Retirement Benefit Plans[6] and (2) IFRS/PFRS 4 Insurance Contracts.

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[3] 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.

[4] PAS 1 para 15 and 17

[5] PAS 1 para 15

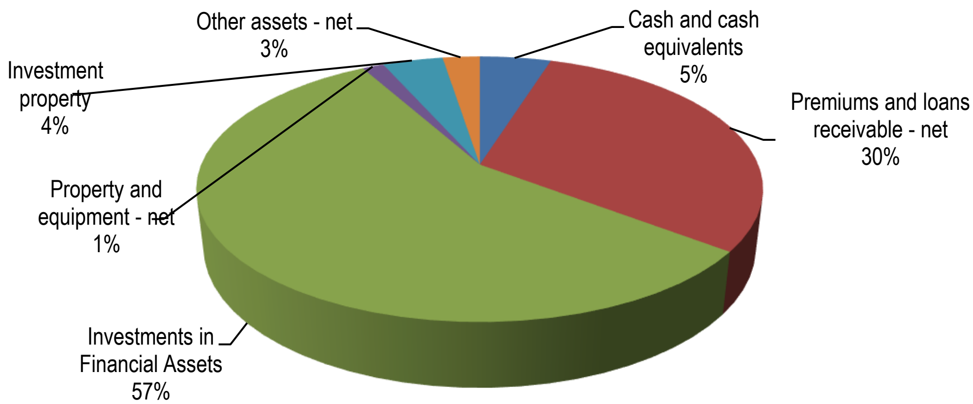
[6] PAS 26 para 7 explicitly excludes "government social security type arrangements" from the scope of the standard. This is likely due to the fact that IAS/IFRS have mostly focused on the financial reporting requirements of profit-oriented entities. However, there is currently no other standard that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

4.3 The Reporting of Assets, Liabilities, Expenses and Reserves (Net Assets Available for Benefits) of the GSIS[7]

Users of the financial statements of the GSIS are most interested in determining the quality and sufficiency in value of its assets and reserves to address its current and future obligations. Users are also interested to know the level of operating costs of the entity to ensure that the GSIS' resources are being used judiciously and efficiently. To provide this information, the GSIS must comply with the reporting requirements of PFRS for its assets, liabilities, reserves and expenses.

The GSIS financial statements provide detailed disclosure regarding the assets of the funds (see Chart 5). The valuation of the assets is in accordance with PFRS; and there is a breakdown of the kinds of loans granted and financial asset investments of the fund in the notes to the financial statements. The reports also provide compliant and informative disclosures on the various financial risks the entity's assets are exposed to and how it is managing those risks.

Chart 5. GSIS Assets (as of 31 December 2012)



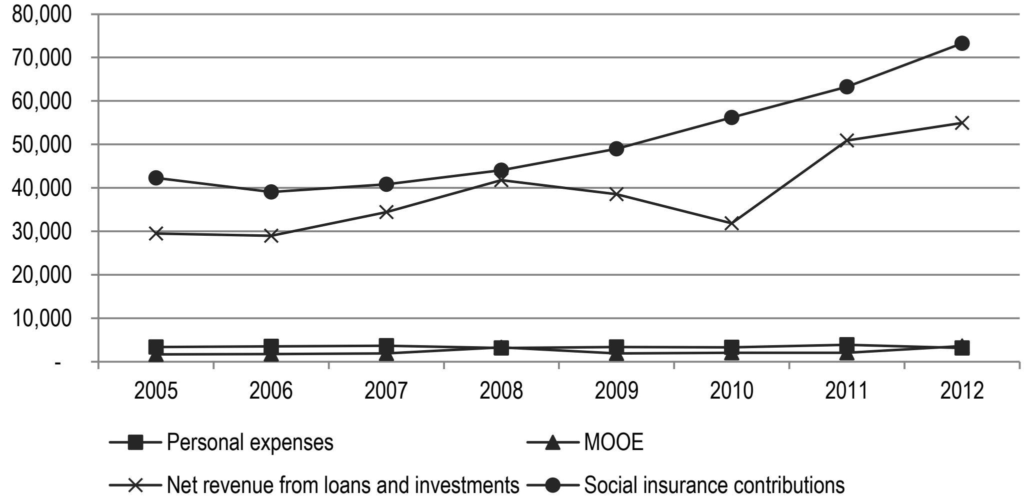
This researcher also does not find exception to the way the GSIS accounts for its expenses. The notes provide a detailed breakdown of all expenses by nature as required by PFRS. As can be seen in Chart 6 below, GSIS has managed to keep its personal and maintenance and other operating expenses relatively stable for the past 8 years despite significant increases in its revenues. By law, the GSIS is allowed "a maximum expense loading of 12% of yearly revenues from all sources"[8] and management reported that this ratio was just 3.5% in 2012.[9]

[7] See Appendix A for a table showing the definition and measurement bases of important assets, liabilities, reserves, revenue and expense accounts of the GSIS.

[8] RA 8291 Sec. 35

[9] GSIS computed its actual "expense or administrative loading" of 3.5% for 2012 by dividing its total administrative and operating expenses, net of impairment loss, by the total of revenues net of investment expenses. This researcher does not find tenable management's arguments that impairment losses should be excluded from the computation because these are "extraordinary" and "non-cash" in nature. If impairment losses were not deducted, the expense loading would have been 4.5%.

Chart 6. GSIS Personal Expenses and MOOE vis-a-vis Social Security Contributions & Net Revenue from Loans and Investments



Non-compliance with the reporting rules, however, is noted in the reporting of reserves and liabilities.

1. There is no disclosure of the "actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits", as required by PAS 26 para. 17. It is noted that the GSIS discloses "actuarial reserves" in its notes to the financial statements; however, as the entity itself explains, actuarial reserves are "the excess of the present value of future benefits *over the present value of future contributions/net premiums* [emphasis added]"[10]. Thus, what GSIS discloses as the amount of its obligations is a lower amount than what the standard requires to be disclosed. This is the likely explanation for the relatively moderate (compared with the magnitude of the SSL3 salary hikes) increases in the SIF actuarial reserves figures from 2005 to 2012, as shown below (see Table 1):

Table 1. Social Insurance Fund Year-on-Year Changes[11]

	2006	2007	2008	2009	2010	2011	2012
SIF Actuarial Reserves Year-on-Year change	12%	12%	9%	6%	11%	13%	10%

The disclosure of the present value of promised retirement benefits and its breakdown between vested and non-vested amounts would have enabled users to more accurately determine the level of the currently unfunded obligations of the social insurance fund. This assessment is currently not possible with the information provided by the GSIS reports.

2. GSIS accounts for its various insurance funds in a similar manner to the Social Insurance Fund. Actuarial reserves are estimated and financial reserves are appropriated from surplus and reported as part of Net Worth in the Statement of Financial Position. This treatment is not consistent with PFRS 4 Insurance Contracts because this standard requires recognition of the entire deficiency as a loss in the profit and loss statement. 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.

[10] GSIS 2012 Financial Statements, note 16

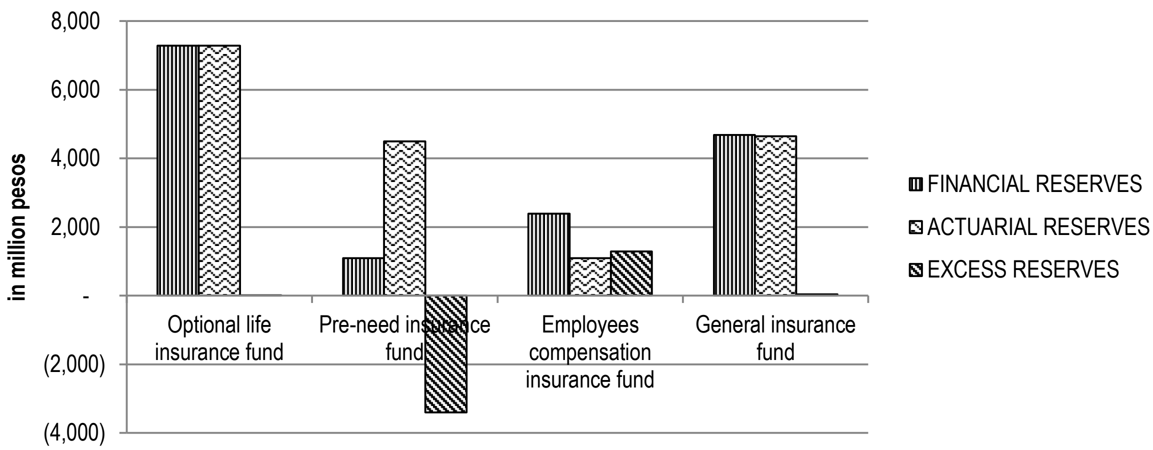
[11] Computed using SIF actuarial reserves reported in the GSIS statements during the period stated

It can be argued that, for most of the insurance funds the GSIS manages, actuarial reserves, which is an estimate of the insurance liability of the GSIS, equals the financial reserves reported in the Statement of Financial Position. The nature of an estimated liability required to be recognized by PFRS 4, however, is completely different from an appropriation of surplus, which is what GSIS presented in its financial statements up to 31 December 2012.

It should be understood that the deficiency cannot be satisfied by a restriction or appropriation from surplus. Such a restriction or appropriation from surplus shows management's policy toward potential losses or expenses but does not create any liability to cover them. As quoted above, the standard requires that the deficiency be recognized as a loss in the profit and loss statement.

Furthermore, as can be seen in Chart 7 below, the actuarial reserve for the pre-need insurance fund exceeds its financial reserves (i.e., funds available for the settlement of the fund's obligations) by P3.4 billion as of 31 December 2012.

Chart 7. Actuarial Reserves vs Financial Reserves of GSIS Insurance Funds (as of 31 December 2012)



If GSIS's insurance liabilities were reported in accordance with PFRS 4, the institution's net worth as of 31 December 2012 should have been lower by P18.8 Billion and its liabilities higher by the same amount. The magnitude of this unreported liability puts into question the unqualified opinion rendered on the GSIS' 2012 financial statements.

5 Financial Condition of the GSIS

The principal financial objectives of a social insurance plan are long-term sustainability and adequate income (ultimately cash flows) to support the payment of promised benefits to all members/ fund contributors.

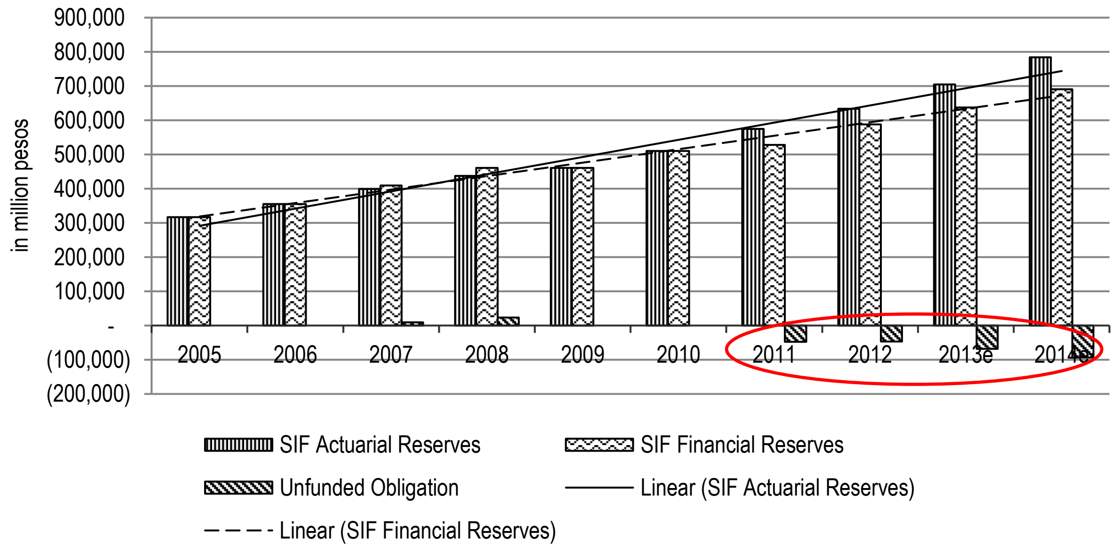
Based on information available in its financial statements, an assessment of GSIS' financial health is made following the procedures below:

1. Comparing financial reserves (net assets appropriated for benefits payable from the fund) with actuarial reserves (present value estimate of liabilities of the fund, net of the present value of expected future contributions as presently computed by GSIS)
2. Comparing the levels of contributions with benefit payments
3. Determining the financial returns from investments made by the fund and comparing this with the "returns" to be paid to beneficiaries
4. Evaluating the appropriateness of the asset allocation of the fund based on its objectives

For the Social Insurance Fund, actuarial reserves equaled financial reserves from 2005 to 2010, and began to exceed the latter in 2011 and 2012 (see Chart 8). The gap of about P46 billion may be said to be sufficiently addressed, however, by unrealized valuation gains that remain in surplus as of

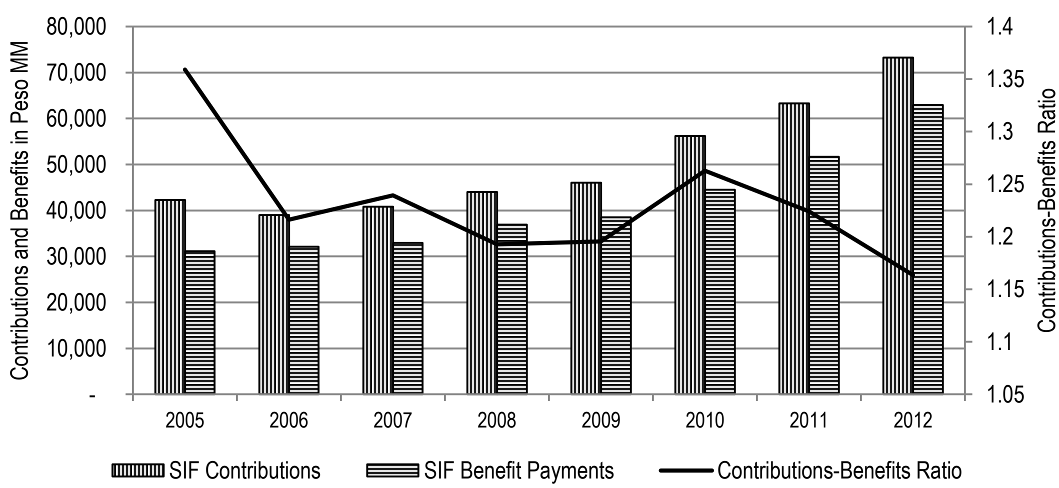
31 December 2012. Per the notes to the financial statements, P51 billion of the P63 billion reported as "Unrealized gain – investments" could have been additional income in 2012 if the GSIS had liquidated its externally managed funds and available-for-sale investments. However, if the actuarial and financial reserves are extrapolated using their compound annual growth rates from 2009 to 2012 (the period of SSL3 implementation) to obtain estimates for 2013 and 2014, one can see that the unfunded obligation continues to increase and in fact will be double the 2011 figure by 2014.

Chart 8. Actuarial vs Financial Reserves GSIS Social Insurance Fund



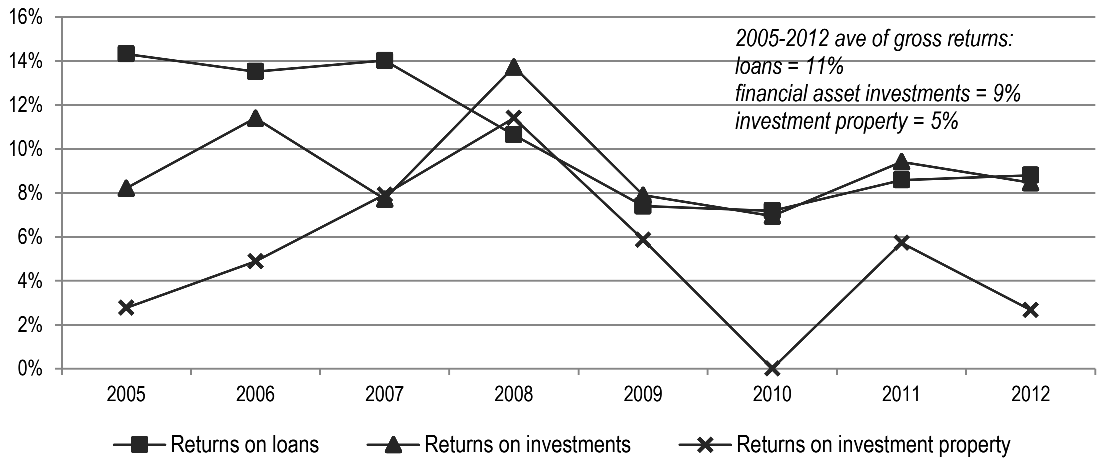
SIF premium collections (contributions) and benefits payments were compared next (see Chart 9). Both are increasing at an increasing rate, but it may not be evident from the chart that claims and benefits have grown faster than collections did from 2009 to 2012 (14.47% versus 11.78% compared with 2.45% versus 3.86% growth rates from 2005 to 2008). The faster growth rates beginning 2009 are almost surely effects of SSL3 implementation. These effects are expected to continue to be felt in the next few years and cause the contributions-to-benefits ratio's persistent decline in the near term.

Chart 9. Contributions and Benefit Payments of the Social Insurance Fund



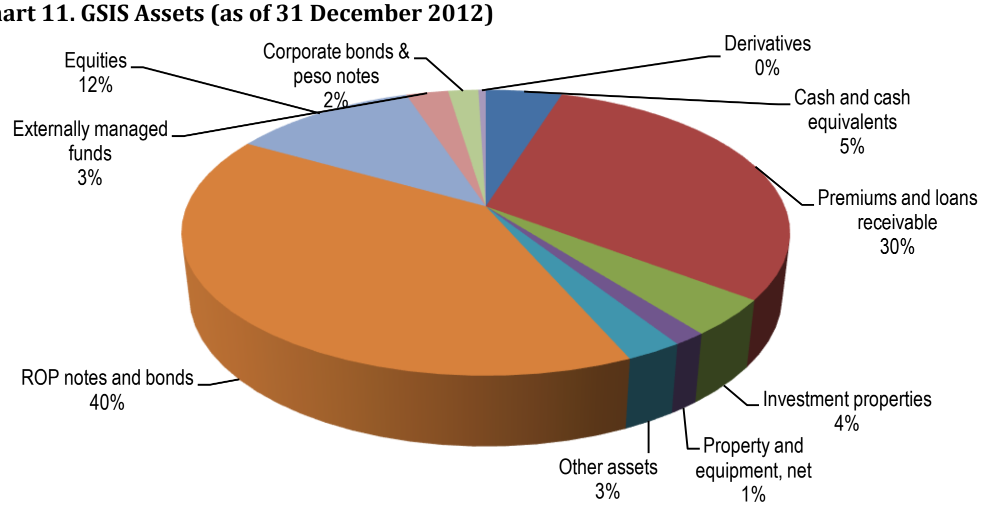
On the matter of investment performance, consistent with the returns on debt and equity instruments in most markets during this period, the returns on GSIS's loans showed a declining trend from 2005 to 2012, averaging 11% over the 8-year period, while those for financial asset investments (mostly government securities, corporate bonds, and equities) showed a steep decline from 2008 to 2010 before recovering in 2011 and 2012, averaging 9% (see Chart 10). Overall, GSIS investments had an average return, after investment expenses, of 10% over the study period. Given that the rate of return on members' contributions is much lower (less than 4%[12]) and assuming this investment performance is maintained, the SIF seems to be in a position to sustain its retirement benefit payments.

Chart 10. Rates of Return on GSIS Investments



Finally, the asset allocation as of year-end 2012 of the SIF is shown below (see Chart 11). Given that the largest allocation is to government securities and loans, the fund may be said to be invested conservatively.

Chart 11. GSIS Assets (as of 31 December 2012)



Based on the foregoing analysis, it can be argued that while SSL3 has caused a deterioration in a number of fund sustainability indicators for the GSIS, the institution appears to still be in a good position to meet its retirement obligations to GSIS members given that its funds are conservatively invested with returns expected to track, if not be at least slightly higher than, the returns promised to members.

[12] based on a simulation done in this study (discussed in next section)

Estimating the Returns on GSIS Contributions Under SSL3

It has been observed that retirement benefits of government employees under GSIS are significantly higher than those received by private-sector employees under the SSS. However, it should also be noted that government employees contribute, as a percentage of their monthly salary, around double the amount contributed by their private sector counterparts.

An important question for both SSS and GSIS members is this: excluding the insurance component of the benefits, what level of financial return does a member earn for the contributions he/she made to the fund? This study estimates this return for GSIS members.

The assumptions of the simulation are as follows:

1. Member starts making contributions at age 24, and does this continuously until the compulsory retirement age in government of 65.
2. The member starts at SG 16 (P28,080/month). This is the starting SG of an Instructor IV at the UP Virata School of Business and, consistent with GSIS actuarial assumptions, the member enjoys a 5% salary rate increase annually.
3. Upon retirement, the member chooses the 18month lump sum + immediate monthly pension option. The basic monthly pension is pegged at the ceiling of 90% of the average monthly compensation.
4. The member retires "permanently" at age 70. Based on the World Health Organization, as of 2012, the life expectancy at birth is 65 years for Filipino men and 72 years for women.

The approach is to estimate the rate at which the future value of the monthly contributions of the GSIS member (excluding the 4% portion for life insurance) equals the value of retirement benefits at his/her retirement. The latter is computed on a present value basis (to the date of retirement) using a discount rate of 3.507%, the 5-year ROP yield as of 15 April 2014.

The simulation shows that the value of GSIS retirement benefits is equivalent to a 3.77% return on the monthly contributions of the member. This approximates the average year on year inflation rate in the last 5 years, and compares unfavorably with the 25-year ROP, which had a yield of over 5.4% last 15 April 2014[13].

The return worsens if the member chooses the 5-year lump sum option, and improves considerably if the member lives up to age 75 (see table 2 below).

Table 2. Estimates of Return on GSIS Members' Monthly Contributions

	Option 1 (5 year lump sum)	**Option 2 (18 month lump sum)**
Base Assumptions	2.53%	3.77%
If member lives to 75 y.o.	5.56%	6.25%

These returns compare favorably to, are in fact higher than, the return estimated to be earned by someone who has invested in a roughly similar pension product offered by a private insurer. At the outset, it must be noted that a privately sponsored and managed pension plan with fixed, guaranteed benefits and a duration as long as 20-25 years is understandably difficult to find. This kind of investment product will be too risky for an entity that does not enjoy sovereign financial backing.

The private sector "benchmark" chosen for this study for its fixed, guaranteed benefits and relatively long duration has the following features:

- 8 years guaranteed paying period
- Guaranteed cash benefits starting at the end of the 8th year and every two years thereafter, until the 20th year
- Total guaranteed cash benefits equals 200% of the Face Amount

[13] The average yield of the 25-year ROP using monthly closing prices from Feb 2013 to Dec 2014 is 5.17%, with a low of 3.83% and a high of 6.33% over this period (accessed 3 Jan 2015); http://www.investing.com/ rates-bonds/philippines-25-year-bond-yield-historical-data

- Cash benefit starts at 8% of the Face Amount, increasing by 2% of the Face Amount every two years, up to a maximum of 20% of the Face Amount
- Lump sum maturity benefit amounting to 102% of the Face Amount, given at the end of 20 years

- Life insurance coverage for 20 years, starting at 100% of the Face Amount and increasing by 16% of the Face Amount for the first 8 years until it reaches the maximum coverage of 228% of the Face Amount[14]
- Special bonus given after 8 years, and dividend earnings starting on the 9th year[15]

The above product has an estimated return (internal rate of return) of 2.15%

6 Concluding Remarks

This paper looked into the financial health and reporting practices of the GSIS and sought to determine the financial return of a member's social security contributions. As mentioned in the introduction, the financial health of the GSIS is of concern not only to its members but also to all taxpayers due to the sovereign guarantee included in the enabling law of the entity. Credible financial statements are needed for a proper assessment of the GSIS' financial health.

The study finds that, for the most part, the financial reporting practices of the GSIS are compliant with Philippine Financial Reporting Standards. GSIS management is also to be commended for the detailed and informative disclosures on the fund's assets, revenues, and expenses. Areas for correction, however, include the reporting of the GSIS' estimated liabilities relating to its issued insurance contracts and members' retirement benefits. Current practice understates GSIS liabilities and overstates its net worth (by at least P18.8 billion as of 31 Dec 2012). The GSIS's profit and loss statements to date do not reflect changes in its estimated insurance liabilities. Users of the financial statements are also not apprised of the "correct" amount of unfunded social insurance liabilities of the institution as the actuarial present value of this obligation (excluding the effect of future contributions) is not disclosed. The COA audit certificate makes mention of these matters, although they were not identified as exceptions but rather as items for "thorough study for proper presentation in the financial statements."

The significant hikes in government salaries from 2009 to 2012 has, as expected, caused a deterioration of the social security fund's sustainability as evidenced by the widening gap between the pension obligations and net assets available for benefits and the declining contributions to benefits ratio beginning 2009. Thankfully, several factors mitigate the adverse effects of the significant hike in pension obligations and payments. These include the high levels and growth rates of monthly contributions to the Social Insurance Fund by government employees, the large difference between fund returns (despite the relatively conservative profile of the investment portfolio) and returns paid to fund contributors, and the low level of administrative expenses of the institution.

Another issue this paper explored is the rate of return on a member's mandatory social security contributions. It is shown that if a member does not exceed the life expectancy age, the financial return on his contributions is less than the opportunity cost of capital as measured by the risk-free rate. The simulation can be improved by excluding the cost of disability insurance from the contributions; but initial attempts to do this show that the returns do not improve significantly even if disability benefits are considered. Considering the lower returns offered by a roughly similar pension product offered by a private insurer and the fact that GSIS benefits are guaranteed by the National Government, members currently are better off continuing their membership in this public institution.

In the course of this study, two questions that have important policy implications kept popping up in the mind of the researcher: To what standards of performance should the GSIS be held? To whom should the GSIS be principally accountable?

The GSIS Board of Trustees, management and employees are currently subject to a performance-based incentive scheme supervised by the Governance Commission for GOCCs as provided for by the GOCC Governance Act of 2011. Under this mechanism, GSIS employees and members of the BOT

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[14] The cost of the life insurance coverage was excluded in the computation of returns (as with the GSIS pension computations).

[15] Excluded in estimating the return as the special bonus and dividend earnings are variable and unguaranteed.

received bonuses of around P60,000 (average per employee) and P1.49 million (average per member of the BOT) for the institution's 2012 performance. Highlighted financial achievements for the entity for that year were the following: increases in total assets (15%), net worth (15%), revenues (11%), and net income (27%). For 2013 and 2014, GSIS's financial targets are a 7% increase in total assets and a 7% average return from investments[16]. Are these broad and absolute financial targets sufficient bases for concluding the institution has performed well for the year? This is arguable given this study's findings on the 2012 financial statements of the GSIS.

The GSIS does not have a regulator in the same way that private sector entities performing the same functions do. RA 8291 included a provision that authorized the Insurance Commission to make an examination of the financial condition and methods of transacting business of the GSIS at least once every three years, but this is not the same as putting the GSIS under the supervision and control of the Insurance Commission. GSIS members are "captive" in the same sense that small electricity consumers within a franchise area are. Should the GSIS and SSS be placed under the direct supervision of a regulator for the greater protection of the members' interests? This is an area for further study.

All funds of the GSIS have come from contributing members. Except for the sovereign guarantee, which is theoretically not necessary if GSIS funds are managed well, the National Government has no financial stake in the institution. Yet, in the governance structure of the GSIS, all members of the Board are Presidential appointees, and, as already noted, representatives of the members are a minority. It is not clear who the members of the banking, finance, investment and insurance sectors are supposed to represent and whose interests they are or will be serving in the Board. How can contributing members hold the GSIS Board of Trustees accountable to them?

There are many positive observations that can be made of how GSIS has been managed in recent years, including in the area of transparency and financial reporting. Nonetheless, there are clear areas of improvement as well. Reforms of the pension fund systems of the Philippines have to continue.

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[16] These financial targets have a 25% weight in the GSIS performance scorecard for 2013-2014 (accessed 3 Jan 2015); http://www.gsis.gov.ph/downloads/Transparencyseal/Performance%20Agreement%20%20GCG%20GSIS%202013_2014%20PES_10232013.pdf

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Appendix A

Accounting Policies on Selected Financial Accounts of the GSIS based on the 2012 Notes to the Financial Statements

Accounts from the Statement of Financial Position		
Account Title	**Definition**	**Measurement Basis**
Loans receivable	loans granted to members, government agencies and private entities	amortized cost; net of allowance for impairment loss
Financial assets	Held for Trading (HFT), Available for Sale (AFS) and Held to Maturity (HTM) securities; as of Dec 31 2012 consisted mostly of ROP notes and bonds (70%), traded stocks (20%), externally managed funds (5%), corporate bonds (3%)	HFT measured at fair value, with changes taken to profit or loss; AFS measured at fair value with changes reflected in other comprehensive income (surplus); HTM measured at amortized cost
Derivative instruments	deliverable and non-deliverable currency forwards and swaps	fair value, with changes in fair value recognized in profit or loss
Investment properties	land or building or part of a building or both, held to earn rentals or for capital appreciation or both; includes foreclosed real properties; as of 31 Dec 2012, consisted mostly of real properties subject to mortgage loan, commercial-industrial loan, or lease purchase agreement to corporations which were foreclosed or acquired through dacion en pago due to non-payment (59%) and cancelled deeds of conditional sale (33%)	fair value, with changes in fair value recognized in profit or loss
Insurance liabilities	consist mostly of claims due to members/policyholders that remain unpaid as of year-end (58.4% in 2012)	Amount payable
Financial reserves	amounts set aside and appropriate from the surplus of a fund to ensure the payment of future obligations as estimated by actuarial reserves;	any increase in actuarial reserves are recorded as financial reserves to the extent of the accumulated earnings net of budgeted expenses (excluding claims) for the following year
Actuarial reserves	Estimated amount of the future obligations of the System under RA 8291 Based on assumptions which are in accordance with generally accepted principles of actuarial valuation, wherein reserves are expressed as the excess of the present value of future benefits over the present value of future contributions/net premiums, given the applicable valuation interest rate based on historical data and taking into consideration a 5% annual salary increase, among others	Actuarially determined values; actuarial reserves are disclosed in the notes but not recognized in the financial statements
Surplus	Net operating revenues less increase in financial reserves, plus other surplus (including unrealized gain in investments)	

Accounts from the Statement of Comprehensive Income		
Account Title	Definition	Measurement Basis
Revenue from insurance contributions	Consist mostly of mandatory contributions provided in RA 8291 (96% in 2012)	recognized as contributions become due; premiums on life insurance policies are earned as consideration for the risks/contingencies insured by the GSIS for the benefit of the members and their beneficiaries
Expenses	Consist mostly of claims and benefits (86.5%), operating expenses (4.8%), and personal expenses (4.3%) [note: percentages for CY 2012]	recognized upon utilization of the service or at the date they are incurred

Source: Audited Financial Statements of the GSIS for CY 2012 (www.gsis.gov.ph)