



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

## STATE AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

### **The Board of Directors**

Philippine Amusement and Gaming Corporation  
PAGCOR Corporate Office  
Hyatt Hotel and Casino Manila  
M. H. Del Pilar cor. Pedro Gil Streets, Malate, Manila

We have audited the accompanying balance sheet of the **Philippine Amusement and Gaming Corporation (PAGCOR)** as of December 31, 2006, and the related statements of income and expenses, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted state auditing standards in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the **Philippine Amusement and Gaming Corporation** as of December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with applicable generally accepted state accounting principles in the Philippines.

**COMMISSION ON AUDIT**

**ROSEMARIE LACSON-LERIO**

Director IV  
Cluster VI - Social, Cultural and Scientific  
Corporate Government Sector

April 4, 2007

**PHILIPPINE AMUSEMENT AND GAMING CORPORATION**  
**CONSOLIDATED BALANCE SHEET**  
**As of December 31, 2006**  
(With Comparative Figures for 2005)

			<u>2006</u>		<u>2005</u>	<u>Increase (Decrease)</u>
<b>ASSETS</b>						
<b>Current Assets</b>						
Cash and Cash Equivalents	(Note 3)	P	3,081,880,304	P	2,953,801,011	P 128,079,293
Receivables - Net	(Note 4)		1,166,998,908		863,702,237	303,296,671
Inventories	(Notes 2.6 & 5)		202,774,489		174,765,908	28,008,581
Prepayments	(Note 6)		<u>319,297,727</u>		<u>209,162,117</u>	<u>110,135,610</u>
Total Current Assets			<u>4,770,951,428</u>		<u>4,201,431,273</u>	<u>569,520,155</u>
<b>Non-Current Assets</b>						
Investments	(Note 7)		41,744,284		42,454,780	(710,496)
Receivables	(Note 8)		78,174,044		83,924,367	(5,750,323)
Property, Plant and Equipment - Net	(Notes 2.7, 2.8 and 9)		1,796,142,836		598,168,287	1,197,974,549
Other Assets	(Note 10)		<u>787,955,870</u>		<u>598,521,541</u>	<u>189,434,329</u>
Total Non-Current Assets			<u>2,704,017,034</u>		<u>1,323,068,975</u>	<u>1,380,948,059</u>
<b>TOTAL ASSETS</b>		<b>P</b>	<b><u>7,474,968,462</u></b>	<b>P</b>	<b><u>5,524,500,248</u></b>	<b>P</b> <b><u>1,950,468,214</u></b>
<b>LIABILITIES AND GOVERNMENT EQUITY</b>						
<b>Current Liabilities</b>						
Accounts Payable	(Note 11)	P	1,138,683,549	P	804,616,989	P 334,066,560
Inter-Agency Payables	(Note 12)		1,975,292,184		1,690,804,593	284,487,591
Intra-Agency Payables	(Note 13)		221,956,340		168,388,000	53,568,340
Other Liability Accounts	(Note 14)		<u>300,575,782</u>		<u>286,965,241</u>	<u>13,610,541</u>
Total Current Liabilities			<u>3,636,507,855</u>		<u>2,950,774,823</u>	<u>685,733,032</u>
<b>Non-Current Liabilities</b>						
Long-Term Liabilities	(Note 15)		588,573,148		988,337,201	(399,764,053)
Deferred Credits	(Note 16)		<u>8,906,606</u>		<u>13,272,967</u>	<u>(4,366,361)</u>
Total Non-Current Liabilities			<u>597,479,754</u>		<u>1,001,610,168</u>	<u>(404,130,414)</u>
<b>TOTAL LIABILITIES</b>			<u>4,233,987,609</u>		<u>3,952,384,991</u>	<u>281,602,618</u>
<b>GOVERNMENT EQUITY</b>			<u>3,240,980,853</u>		<u>1,572,115,257</u>	<u>1,668,865,596</u>
<b>TOTAL LIABILITIES AND GOVERNMENT EQUITY</b>		<b>P</b>	<b><u>7,474,968,462</u></b>	<b>P</b>	<b><u>5,524,500,248</u></b>	<b>P</b> <b><u>1,950,468,214</u></b>

See accompanying Notes to Financial Statements.

**PHILIPPINE AMUSEMENT AND GAMING CORPORATION**  
**CONSOLIDATED STATEMENT OF INCOME AND EXPENSES**  
**For the Year Ended December 31, 2006**  
(With Comparative Figures for 2005)

		<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>
<b>Business Income</b>				
Winnings	P	19,426,990,724	P 20,274,893,157	P (847,902,433)
Bingo Operations-Franchisees		1,433,044,822	1,374,675,921	58,368,901
Bingo Operations - In-House		107,082,320	105,778,364	1,303,956
Rent Income		413,184,314	511,763,250	(98,578,936)
Management Fees	(Note 18)	191,093,188	183,404,061	7,689,127
Entertainment		2,550,882	2,166,443	384,439
Hotel Operations		1,741,037	(564,277)	2,305,314
Gasoline Service Operations		981,722	1,164,950	(183,228)
Others		21,628	7,668,416	(7,646,788)
<b>Other Income</b>	(Note 19)	2,729,923,793	942,432,869	1,787,490,924
<b>Gain (Loss) on Foreign Exchange</b>	(Note 2.9)	<u>(15,276,753)</u>	<u>(4,142,398)</u>	<u>(11,134,355)</u>
		<u>24,291,337,677</u>	<u>23,399,240,756</u>	<u>892,096,921</u>
<b>EXPENSES</b>				
Operating Expenses	(Note 20)	10,369,114,760	9,562,680,264	806,434,496
Franchise Tax	(Note 21)	<u>971,349,536</u>	<u>1,013,744,658</u>	<u>(42,395,122)</u>
		<u>11,340,464,296</u>	<u>10,576,424,922</u>	<u>764,039,374</u>
Contributions to the Government	(Note 22)			
50% Government Share		9,719,074,063	9,630,574,250	88,499,813
Office of the President		1,027,283,302	900,204,692	127,078,610
5% Philippine Sports				
Commission's Share		485,953,703	481,528,713	4,424,990
Subsidy to LGUs: Host				
Cities' Share		466,120,000	454,010,000	12,110,000
Early Childhood Care & Development Fund		124,960,195	321,000,000	(196,039,805)
Gasoline Station Training & Loan Fund		63,500,000	70,000,000	(6,500,000)
Barangay Micro Business Enterprises		42,500,000	58,958,333	(16,458,333)
1% Board of Claims' Share		16,240,539	11,578,176	4,662,363
National Endowment Fund for Children's TV		9,000,000	12,000,000	(3,000,000)
Mandated Contribution to the National Government - Others		<u>21,887,916</u>	<u>13,779,977</u>	<u>8,107,939</u>
		<u>11,976,519,718</u>	<u>11,953,634,141</u>	<u>22,885,577</u>
		<u>23,316,984,014</u>	<u>22,530,059,063</u>	<u>786,924,951</u>
Net Income from Continuing Operations		974,353,663	869,181,693	105,171,970
Net Income from Discontinued Operations (Note 23)		<u>674,568,227</u>	<u>-</u>	<u>674,568,227</u>
<b>NET INCOME</b>	<b>P</b>	<b><u>1,648,921,890</u></b>	<b><u>869,181,693</u></b>	<b><u>779,740,197</u></b>

See accompanying Notes to Financial Statements.

**PHILIPPINE AMUSEMENT AND GAMING CORPORATION**  
**STATEMENT OF CHANGES IN EQUITY**  
**For the Year Ended December 31, 2006**  
(With Comparative Figures for 2005)

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>
<b>Government Contribution</b>			
(100% Government-Owned and -Controlled Corporation)			
Balance Beginning/End	P 71,430,752	P 71,430,752	-
<b>Appraisal Capital (Note 17)</b>			
Balance Beginning/End	85,506,455	85,506,455	-
<b>Retained Earnings</b>			
Unappropriated Balance, Beginning	977,565,164	598,858,499 P	378,706,665
Prior Year Adjustment	19,943,705	(232,862,142)	252,805,847
Net Income	1,648,921,890	869,181,693	779,740,197
	<u>2,646,430,759</u>	<u>1,235,178,050</u>	<u>1,411,252,709</u>
Current Appropriations			
SM Demo Units	(502,088,000)	(119,260,000)	(382,828,000)
Acquisition of Other CAPEX	(74,909,419)	(108,352,886)	33,443,467
ECCD	-	(30,000,000)	30,000,000
	<u>(576,997,419)</u>	<u>(257,612,886)</u>	<u>(319,384,533)</u>
Unappropriated Balance, End	<u>2,069,433,340</u>	<u>977,565,164</u>	<u>1,091,868,176</u>
Appropriated Balance, Beginning	437,612,886	180,000,000	257,612,886
Current Appropriations	<u>576,997,420</u>	<u>257,612,886</u>	<u>319,384,534</u>
Appropriated Balance, End	<u>1,014,610,306</u>	<u>437,612,886</u>	<u>576,997,420</u>
	<u>3,084,043,646</u>	<u>1,415,178,050</u>	<u>1,668,865,596</u>
<b>STOCK HOLDER'S EQUITY</b>	<b>P <u>3,240,980,853</u></b>	<b>P <u>1,572,115,257</u></b>	<b>P <u>1,668,865,596</u></b>

See accompanying Notes to Financial Statements.

**PHILIPPINE AMUSEMENT AND GAMING CORPORATION**  
**STATEMENT OF CASH FLOWS**  
**For the Year Ended December 31, 2006**  
(With Comparative Figures for 2005)

	<b>2006</b>	<b>2005</b>
Income from Casino Customers	P 20,461,208,553	P 20,274,893,157
Income from Chip Washing Operations, Non-casino Customers and Other Income	4,836,826,342	2,797,996,296
Interest Income	107,438,139	110,083,052
Payments to Employees, Suppliers, Lessors and Other Creditors	(10,337,362,458)	(8,810,878,265)
Other Operating Disbursements	(12,290,689,030)	(12,456,465,133)
Various Taxes Paid to the Bureau of Internal Revenue	(996,430,107)	(989,451,643)
Interest Paid on Loans	(34,253,056)	(52,825,236)
Loss on Foreign Exchange	(15,276,903)	(4,142,398)
	<b>1,731,461,480</b>	<b>869,209,830</b>
Proceeds from Sale of Marketable Stocks and Bonds	726,400	-
Proceeds from Sale of Property, Plant and Equipment	21,628	-
Purchase of Property, Plant and Equipment	(1,331,895,520)	(344,780,707)
Investment in Stocks/Bonds/Treasury Bills	(15,905)	326,500
	<b>(1,331,163,397)</b>	<b>(345,107,207)</b>
Loan Proceeds	40,000,000	100,650,000
Payment of Loans	(312,218,790)	(327,669,069)
	<b>(272,218,790)</b>	<b>(227,019,069)</b>
	<b>128,079,293</b>	<b>297,083,554</b>
	<b>2,953,801,011</b>	<b>2,656,717,457</b>
	<b>P 3,081,880,304</b>	<b>P 2,953,801,011</b>

See accompanying Notes to Financial Statements.

**PHILIPPINE AMUSEMENT AND GAMING CORPORATION  
NOTES TO FINANCIAL STATEMENTS**

**1. GENERAL INFORMATION**

The Philippine Amusement and Gaming Corporation (PAGCOR), with business address at Hyatt Hotel and Casino Manila, M. H. Del Pilar cor. Pedro Gil Streets, Malate, Manila, is a 100 per cent government-owned and controlled corporation domiciled in the Republic of the Philippines. It was created on January 1, 1977 by virtue of Presidential Decree (PD) No. 1067-A. This was amended under PD Nos. 1067-B, 1067-C, 1399 and 1632 which were subsequently consolidated into one statute, PD No. 1869 (PAGCOR's Charter), on July 11, 1983. PAGCOR was created with a three-pronged mandate: to regulate all games of chance, particularly casino gaming in the country, to raise funds for the government's socio-civic and national developmental efforts, and to help boost the country's tourism industry. PAGCOR's 25-year franchise, which is expiring on July 11, 2008, has been renewed by Congress for another 25 years or until July 11, 2033.

PAGCOR currently has 11,935 employees and operates 13 Casino Filipino (CF) branches in major cities in the country, aside from slot machine arcades and Casino Filipino VIP clubs. These casinos are the Airport Casino in Parañaque, CF Heritage in Pasay City, CF Hyatt and CF Pavilion in Manila, CF Angeles, CF Bacolod, CF Cebu, CF Davao, CF Laoag, CF Mactan, CF Mimosa in Clark, Pampanga, CF Olongapo, and CF Tagaytay. Another casino, CF Silahis located in Manila, ceased operation on July 31, 2006.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**2.1 Basis of Accounting**

From July 15 to December 31, 1986, PAGCOR followed the accrual basis of accounting. However, in 1987, the corporation shifted to the modified cash basis of accounting on account of PAGCOR's commitment to directly transfer its net cash income to the Social Fund under the Office of the President. Under this method of accounting, the company recognized winnings, rental and other income when collected, regardless of when they were earned. Likewise, operating and other expenses were generally recognized when paid regardless of when they were incurred. Capital expenditures were also immediately charged to expense so that depreciation was no longer provided.

Subsequently, in compliance with (a) COA Circular No. 2004-002 dated April 29, 2004 - Prescribing the Chart of Accounts Under the New Government Accounting System (NGAS) for Government-Owned and/or - Controlled Corporations, and (b) COA Circular Letter No. 2004-001 dated May 7, 2004 - Accounting Guidelines and Procedures on the Adoption of the Chart of Accounts under the New Government Accounting System (NGAS) by Government-Owned and/or Controlled Corporations, PAGCOR adopted the NGAS and shifted from the modified cash to accrual basis of accounting, effective January 1, 2005, as approved by the Board of Directors on May 25, 2004.

## **2.2 Basis of Financial Statement Preparation**

PAGCOR's financial statements have been prepared in accordance with generally accepted accounting principles as set forth in the Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS). PAGCOR will implement in 2007 the provisions of PAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, with respect to prior period adjustments via the restatement of comparative financial statements.

## **2.3 Consolidation of Financial Statements**

The consolidated financial statements of PAGCOR reflect the financial position and results of operations of the Home Office and its branches. Inter-branch accounts have been eliminated in the consolidation.

## **2.4 Presentation Currency**

PAGCOR's financial statements are presented/ reported in Philippine peso, its functional currency, or the currency of the primary economic environment in which the company operates.

## **2.5 Revenue Recognition**

Income is generally recognized when realized or earned, except for revenues where the accrual method is impractical, such as table games and slot machine winnings, since these cannot be measured reliably until cash is actually received.

## **2.6 Inventory Procedure and Valuation Method**

Supplies and materials purchased for stock, whether these are consumed or not within the accounting period, are recorded using the Perpetual Inventory System. The cost of inventory issued and its ending balance is computed using the Moving Average Method.

## **2.7 Property, Plant and Equipment**

Depreciation Method - As required under NGAS, particularly COA Circular No. 2003-007 dated December 11, 2003, the straight-line method of computing depreciation for property, plant and equipment is followed by PAGCOR.

Subsequent Acquisitions - Except for the initial set-up of existing property, plant and equipment following the shift from modified cash to accrual basis of accounting on January 1, 2005, property, plant and equipment are recorded at historical cost.

Estimated Useful Lives - PAGCOR has generally complied with COA Circular No. 2003-007 on the Revised Estimated Useful Life in Computing Depreciation for Government Property, Plant and Equipment (PPE). However, in view of the nature of the company's business and specialized equipment used (e.g. CCTV, slot machines and gaming tables), different estimated useful lives for certain assets have been adopted. The Commission on Audit's approval has been

sought on this in PAGCOR's memo to COA - PAGCOR dated October 29, 2004. The schedule of estimated useful lives of PPE is shown below:

Particulars	Estimated Useful Life (in years)
Buildings	30
Leasehold Improvements	30, or term of lease, or expiry of PAGCOR's franchise on July 11, 2008. whichever is shorter
Office Equipment	5 to 10
Office Furniture and Fixtures	10
Gaming Furniture and Fixtures	4 to 10
IT Equipment	5
IT Software	3
Communication Equipment	10
Firefighting Equipment and	10
Medical, Dental and Laboratory	10
Military and Police Equipment	10
Sports Equipment	10
Gaming Equipment	4 to 5
Bingo Equipment	5
Other Machinery and Equipment	10
Transportation Equipment	7 to 10
Chips and Tokens	Indefinite *
Other Property, Plant and	5

\*The estimated useful life of chips and tokens cannot be accurately determined as even those purchased prior to 1986 are still being used. Hence, no depreciation has been computed for this item.

## 2.8 FACE VALUE OF CHIPS AND TOKENS

The actual PAGCOR chips and tokens used in the casino operations of the branches have the following total values as of December 31, 2006:

Branches	Chips	Tokens	Total	Dollar Chips
Airport	P 152,633,100	P 9,529,220	P 162,162,320	\$ 1,709,666
Angeles	63,223,665	5,542,300	68,765,965	746,664
Bacolod	34,207,400	4,578,521	38,785,921	
Cebu	136,347,340	6,899,582	143,246,922	2,000,450
Davao	53,600,920	4,294,304	57,895,224	549,695
Heritage	219,744,000	7,222,042	226,966,042	4,070,459
Hyatt	545,521,928	9,523,980	555,045,908	
Laoag	73,201,380	2,803,020	76,004,400	
Mactan	63,635,320	4,920,733	68,556,053	1,594,304
Mimosa	39,252,730	1,790,100	41,042,830	401,138
Olongapo	37,789,140	2,411,607	40,200,747	249,957
Pavilion	434,317,360	15,038,474	449,355,834	1,706,796
Tagaytay	69,049,80	7,143,84	76,193,64	499,051
	<u>0</u>	<u>0</u>	<u>0</u>	

P 1,922,524,083 P 81,697,723 P 2,004,221,806 \$ 13,528,180

## 2.9 Foreign Exchange Transactions

Foreign currency transactions, such as dollar pit winnings, are recorded on initial recognition in PAGCOR's functional currency (Philippine peso) by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the transaction, which is defined as the date on which the transaction first qualifies for recognition in accordance with Philippine Financial Reporting Standards (PFRS). In the case of dollar pit winnings, this is the actual date on which the winnings are generated from the tables.

At each subsequent balance sheet date henceforth, foreign currency monetary items, such as "Cash in Bank – Foreign Currency" and dollar "Treasury Capital" accounts, are revalued/translated using the closing rate (spot exchange rate at the balance sheet date), with the difference recognized as Foreign Exchange Gain or Loss.

## 3. CASH AND CASH EQUIVALENTS

This account includes the following:

	<u>2006</u>	<u>2005</u>
Cash on Hand	P 57,051,921	P 50,575,106
Cash in Bank - Local Currency	2,329,677,201	2,006,388,678
Cash in Bank - Foreign Currency	261,336,061	449,892,087
Treasury Fund Capital	<u>433,815,121</u>	<u>446,945,140</u>
	<u>P 3,081,880,304</u>	<u>P 2,953,801,011</u>

Cash on Hand – This consists of collections and deposits made by Collecting Officers, amount of cash advances granted to Regular and Special Disbursing Officers for payment of salaries and disbursements made in payment of authorized official expenditures including Intelligence Fund and Discretionary Fund. It also includes Petty Cash Funds and various revolving funds maintained in the Home Office and branches.

Cash in Bank – Local/Foreign Currency - This account represents the bank accounts with the Philippine National Bank, Hongkong and Shanghai Banking Corporation and Land Bank of the Philippines maintained by the Home Office and branches. It includes placements in time deposits which can be pre-terminated when necessary, except for P135,000,000 which has been set aside for the Early Childhood Care and Development (ECCD) and P75,000,000 for the Gasoline Station Training and Loan Fund.

Treasury Fund Capital - This account pertains to the cash capital for gaming operations kept in the vault of the branches' Treasury and back-up capital deposited in the banks.

#### 4. CURRENT RECEIVABLES – NET

This account is broken down as follows:

	<u>2006</u>	<u>2005</u>
<b>Accounts Receivable</b>		
Officers and Employees	₱ 2,155,340	₱ 1,611,845
Allowance for Doubtful Accounts	-	(18,510)
	<u>2,155,340</u>	<u>1,593,335</u>
Others	598,698,336	560,160,375
Allowance for Doubtful Accounts	( 319,574,051)	(277,685,909)
	<u>279,124,285</u>	<u>282,474,466</u>
Due from Officers and Employees	14,117,913	23,711,374
Interest Receivable	2,723,120	5,928,600
	<u>298,120,658</u>	<u>313,707,775</u>
<b>Inter-Agency Receivables</b>		
Due from National Government Agencies		
Philippine Sports. Commission	219,050,627	246,455,556
Office of the President	60,000,000	116,861,769
Others	326,944,483	-
Due from Government-Owned and -Controlled Corporation		
Social Security System	2,604,580	2,445,097
Others	4,600	4,600
	<u>608,604,290</u>	<u>365,767,022</u>
<b>Other Receivables</b>	<u>260,273,960</u>	<u>184,227,440</u>
	<b>₱ <u>1,166,998,908</u></b>	<b>₱ <u>863,702,237</u></b>

Accounts Receivable – Officers and Employees – This account represents amount due from officers and employees for the sale of bingo and show tickets, souvenir shop items and gas charges from PAGCOR's gasoline station.

Accounts Receivable – Others – This refers to trade receivables from other companies, individuals and organizations, such as gasoline/oil withdrawals by the National Parks Development Committee and amount due from bingo franchises.

Due from Officers and Employees – This includes the personal accounts of officers and employees such as death benefits, telephone charges and meal charges.

Interest Receivable – This represents accrued interest income from Peso and Dollar time deposits as of December 31, 2006.

Due from National Government Agencies - This account consists of the amount advanced to Philippine Sports Commission; remaining balance of ₱60 million out of the ₱220 million deducted from the 50% government share for April 1998 which

should have been deducted from the Social Fund, Office of the President; and outstanding balance of the advance payment of franchise tax to the Bureau of Internal Revenue.

Due from GOCCs – This account pertains to the amount advanced for the maternity and sickness benefits of officers and employees from the Social Security System and the receivable account of CF Pavilion from the Government Service Insurance System for the cost of vehicle repair.

Other Receivables – This account consists of the amounts due from the following:

	<b>2006</b>	<b>2005</b>
Carplan/Comprehensive Insurance	₱ 116,770,897	₱ 112,168,989
Healthcare	50,974,366	35,639,792
Waterfront Hotel	34,269,480	-
National Broadcasting Network	15,000,000	-
Megaworld Corporation	13,432,500	13,432,500
Employee-Funded Mutual Assistance Program	12,546,858	4,642,552
Adriatico Consortium, Inc.	7,667,520	7,667,520
Evercrest Golf Club	720,000	720,000
Century Resort Hotel Corp	700,640	4,099,162
Tagaytay Character Convention Hotel	604,000	-
Others	7,587,699	5,856,925
	<b>₱ 260,273,960</b>	<b>₱ 184,227,440</b>

## 5. INVENTORIES

This account consists of the following:

	<b>2006</b>	<b>2005</b>
Other Supplies	₱ 101,658,653	₱ 81,235,789
Spare Parts	27,972,392	30,359,748
Merchandise	26,297,679	26,297,841
Office Supplies	22,795,280	16,834,498
Food Supplies	9,051,190	9,620,466
Construction Materials	4,543,171	3,124,195
Raw Materials	3,837,789	1,649,582
Work - In Process	2,863,061	1,144,300
Drugs and Medicines	1,570,617	2,765,875
Finished Goods	872,505	187,421
Medical, Dental and Laboratory Supplies	741,540	868,376
Accountable Forms	570,612	677,817
	<b>₱ 202,774,489</b>	<b>₱ 174,765,908</b>

## 6. PREPAYMENTS

This account includes the following:

	<b>2006</b>	<b>2005</b>
Rent	₱ 261,660,888	₱ 162,032,349
Clothing and Uniform Allowance	25,089,239	-
Deferred Charges	15,793,790	27,107,706
Insurance	15,046,202	15,922,541
Others	1,707,608	4,099,521
	<b>₱ 319,297,727</b>	<b>₱ 209,162,117</b>

## 7. INVESTMENTS

This pertains to investments in stocks of the following:

	<b>2006</b>	<b>2005</b>
Wack-Wack Golf and Country Club	₱ 20,500,000	₱ 20,500,000
Rockwell Land Corporation	4,222,000	4,222,000
Cebu Golf and Country Club	2,500,000	2,500,000
Alabang Country Club	2,167,500	2,167,500
Philippine Long Distance Telephone Co.	1,792,404	1,776,500
Tagaytay Highlands International Golf Club	1,475,000	1,475,000
The Orchard Golf and Country Club	1,350,000	1,350,000
Alta Vista Golf & Country Club/Vista Mar Beach Resort	1,070,000	1,070,000
Baguio Country Club	1,067,000	1,067,000
Tagaytay Midlands Golf Club	950,000	950,000
Riviera Golf and Country Club	910,000	910,000
Eastridge Golf Club	900,000	900,000
Banyan Tree Nasugbu Evercrest	800,000	800,000
Fairway Country Club and Bluewater Resort	704,000	704,000
Mimosa Golf and Country Club	622,500	622,500
Apo Golf and Country Club	400,000	400,000
Tagaytay Royale Estate	148,500	148,500
Greenland Resort	70,000	70,000
Romeo G. Guanzon Recreation Center	50,000	50,000
Philippine Columbian Association	32,000	32,000
Pilipino Telephone Corporation	13,380	7,380
Subic Bay Country Club	-	726,400
	-	6,000
	<b>₱ 41,744,284</b>	<b>₱ 42,454,780</b>

## 8. NON-CURRENT RECEIVABLES

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Century Resort Hotel Corporation - remaining balance of financial accommodation for the general finishing works on the new building of Casino Filipino Angeles.	P 57,931,544	P 63,164,367
Century Resort Hotel Corporation – Financial accommodation for the construction of the rent-free basement parking area.	18,000,000	18,000,000
Remaining balance of account which is being paid in monthly amortizations of P43,125 per Compromise Agreement of Civil Case No. 97-31299.	2,242,500	2,760,000
	<u>P 78,174,044</u>	<u>P 83,924,367</u>

## 9. PROPERTY, PLANT AND EQUIPMENT - NET

This account consists of the following:

	<u>Land &amp; Improvements</u>	<u>Buildings &amp; Other Structures</u>	<u>Leasehold Improvements</u>	<u>Construction in Progress</u>	<u>Furniture &amp; Equipment</u>	<u>Total</u>
<b>COST</b>						
Jan. 1, 2006	P 65,943,265	P 85,506,456	P 1,948,050	P 65,449,880	P 409,935,218	P 628,782,869
Additions	1,100,440	159,837	41,528,822	101,155,254	1,189,629,287	1,333,573,640
Disposals/ Retirement	-	-	-	-	(1,678,121)	(1,678,121)
<b>Dec. 31, 2006</b>	<u>67,043,705</u>	<u>85,666,293</u>	<u>43,476,872</u>	<u>166,605,134</u>	<u>1,597,886,384</u>	<u>1,960,678,388</u>
<b>Accumulated Depreciation</b>						
Jan. 1, 2006	-	2,295,123	97,794	-	28,221,665	30,614,582
Depreciation	36,681	2,360,756	328,725	-	131,194,808	133,920,970
<b>Dec. 31, 2006</b>	<u>36,681</u>	<u>4,655,879</u>	<u>426,519</u>	<u>-</u>	<u>159,416,473</u>	<u>164,535,552</u>
<b>NET BOOK VALUE, Dec. 31, 2006</b>	<u>P 67,007,024</u>	<u>P 81,010,414</u>	<u>P 43,050,353</u>	<u>P 166,605,134</u>	<u>P 1,438,469,911</u>	<u>P 1,796,142,836</u>
<b>NET BOOK VALUE, Dec. 31, 2005</b>	<u>P 65,943,265</u>	<u>P 83,211,333</u>	<u>P 1,850,256</u>	<u>P 65,449,880</u>	<u>P 381,713,553</u>	<u>P 598,168,287</u>

Construction in Progress represents the cost or accumulated value of PAGCOR assets still under construction.

## 10. OTHER ASSETS

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Miscellaneous Deposits	₱ 498,430,039	₱ 482,782,563
Advances to Provident Fund	180,648,395	115,278,406
Deferred Charges	68,420,124	-
Guarantee Deposits	40,357,312	360,572
Others	100,000	100,000
	<u>₱ 787,955,870</u>	<u>₱ 598,521,541</u>

## 11. ACCOUNTS PAYABLE

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Accounts Payable - Contractors / Suppliers	₱ 595,854,368	₱ 280,623,223
Accounts Payable - Proponents	221,132,431	273,930,955
Accounts Payable - Others	190,021,214	111,098,628
Due to Officers and Employees – Bonuses/Other Employees' Benefits	127,799,315	135,047,693
Unclaimed Salaries and Wages	2,914,949	1,906,034
Interest Payable	961,272	2,010,456
	<u>₱ 1,138,683,549</u>	<u>₱ 804,616,989</u>

## 12. INTER-AGENCY PAYABLES

This account pertains to the following:

	<u>2006</u>	<u>2005</u>
Due to National Treasury	₱ 842,986,604	₱ 755,726,159
Due to Bureau of Internal Revenue	465,582,698	427,484,280
Due to Other National Government Agencies	634,839,132	474,628,205
Due to Pag-Ibig	4,868,875	4,597,578
Due to PHILHEALTH	3,181,534	3,298,675
Due to Other Government-Owned and -Controlled Corporations	20,503,341	22,639,696
Due to Local Government Units	3,330,000	2,430,000
	<u>₱ 1,975,292,184</u>	<u>₱ 1,690,804,593</u>

### 13. INTRA-AGENCY PAYABLES

This account consists of the following:

	<u>2006</u>	<u>2005</u>
Due to PAGCOR Retirement Fund	₱ 221,470,125	₱ 167,611,250
Due to Retired/Separated Employees	486,215	776,750
	<u>₱ 221,956,340</u>	<u>₱ 168,388,000</u>

As of December 31, 2006, the total amount of ₱ 952,803,095, including the initial funding of ₱ 60,000,000, has already been set up, i.e. recognized as expense and liability. Of this amount, ₱ 731,332,970 has been remitted to the Retirement Fund managed by the Provident Fund Management Department (PFMD) in accordance with the Modified Retirement/Separation Benefit Plan, leaving a balance of ₱ 221,470,125.

### 14. OTHER LIABILITY ACCOUNTS

These are the following:

	<u>2006</u>	<u>2005</u>
Guarantee Deposits Payable	₱ 113,645,655	₱ 103,097,798
Other Payables	186,930,127	183,867,443
	<u>₱ 300,575,782</u>	<u>₱ 286,965,241</u>

### 15. LONG-TERM LIABILITIES

PAGCOR has the following long-term liabilities:

	<u>2006</u>	<u>2005</u>
Loans Payable – Domestic	₱ 427,597,287	₱ 699,816,077
Guarantee Deposits Payable	160,975,861	288,521,124
	<u>₱ 588,573,148</u>	<u>₱ 988,337,201</u>

Loans Payable – Domestic pertains to the credit accommodations extended by Land Bank of the Philippines, Philippine National Bank and PAGCOR Provident Fund to finance the (a) importation of slot machines, (b) settlement of claims relative to Jai-alai operations, (c) rental payments of CF-Cebu and CF-Mactan for CYs 2001 to 2003, (d) advance rental of CF-Cebu for CY 2004, (e) refinancing of major construction projects of CF-Angeles, (f) cash advances to Philippine Sports Commission, and (g) payment of earnest money for the purchase of the 40-hectare property of the Philippine Reclamation Authority at Central Business Park I in Parañaque City.

Guarantee Deposits Payable consists of deposits made by suppliers, bingo franchises and others, as required by PAGCOR, to ensure the delivery of supplies or services, refundable upon fulfillment of the contract. Also included are cash deposits from proponents of certain gaming operations.

## 16. DEFERRED CREDITS

This account pertains to the amount collected for revenues not yet earned, set-up of development cost of Imus Housing Project payable by employee-availees over five years, and training accountabilities of PAGCOR employees.

## 17. APPRAISAL CAPITAL

This refers to the increase in the value of buildings and other structures as a result of the appraisal conducted by Land Bank of the Philippines, contained in its Appraisal Reports dated August 6 and 7, 2004. The appraised values of property and equipment were used as bases in the initial set-up of property and equipment accounts in calendar year 2005 when PAGCOR shifted from modified cash to accrual basis of accounting in the implementation of the New Government Accounting System.

## 18. MANAGEMENT FEES

This refers to the income share received by PAGCOR equivalent to a certain percentage of winnings for the month from the Clark Development Corporation's casino in Mimoso.

## 19. OTHER INCOME

This account is composed of the following:

	<u>2006</u>	<u>2005</u>
Income from SM Demo Units	₱ 1,583,971,109	₱ 378,929,595
Share in the income of		
Fontana Casino	294,037,413	60,109,816
East Bay Casino	168,485,776	126,741,413
Internet Casino	168,630,496	99,123,498
Subic Diamond Casino	96,277,477	43,880,150
Poro Point Casino	86,404,564	-
Legenda Casino	20,000,000	-
Internet Soccer	9,600,000	10,400,000
Cagayan Economic Zone	5,272,570	3,951,945
Interest income	104,232,659	116,011,652
Rental of Equipment/facilities	55,840,018	22,355,223
Minimum guaranteed fee/reimbursement of salaries	41,929,405	-
Commissions	37,166,388	13,701,308
Dividend income	95,300	125,453
Others	57,980,618	67,102,816
	<u>₱ 2,729,923,793</u>	<u>₱ 942,432,869</u>

## 20. OPERATING EXPENSES

This account consists of the following:

	<u>2006</u>	<u>2005</u>
<b>Personal Services</b>		
Salaries and Wages	₱ 1,108,889,481	₱ 1,149,885,441
Other Compensation	1,564,126,136	1,397,705,030
Personnel Benefits Contribution	131,695,001	134,661,754
Other Personnel Benefits	2,752,212,576	2,542,277,892
	<u>5,556,923,194</u>	<u>5,224,530,117</u>
<b>Maintenance and Other Operating Expenses</b>	-	-
Marketing Expenses	1,485,717,849	1,357,036,742
Rent Expenses	1,182,477,069	1,228,050,481
Utility Expenses	435,485,003	389,341,891
Confidential, Intelligence, Extraordinary and Miscellaneous Expenses	322,731,615	297,780,338
Supplies and Materials Expenses	229,387,356	245,147,701
Professional Services	203,168,368	182,907,958
Non-Cash Expenses	190,143,730	32,697,771
Advertising Expenses	177,739,632	101,324,396
Subsidies and Donations	114,797,123	57,563,887
Repairs and Maintenance	104,233,799	100,425,420
Representation Expenses	57,683,550	46,796,290
Taxes, Insurance Premiums & Other Fees	55,572,210	45,614,272
Public Relations Expenses	52,877,930	59,124,164
Entertainment Expenses	40,324,414	35,135,248
Communication Expenses	38,522,275	35,387,445
Traveling Expenses	37,696,265	25,366,859
Training and Scholarship Expenses	12,199,675	10,952,448
Transportation & Delivery Expenses	5,307,609	3,270,926
Subscription Expenses	2,758,669	3,038,445
Membership, Dues & Contributions	1,690,476	1,306,310
Printing and Binding Expenses	370,999	464,240
Other Maintenance and Operating Expenses	27,565,805	23,683,011
Financial Charges	33,740,145	55,733,904
	<u>4,812,191,566</u>	<u>4,338,150,147</u>
	₱ <u>10,369,114,760</u>	₱ <u>9,562,680,264</u>

## 21. FRANCHISE TAX

This account refers to the 5% tax computed on winnings net of losses.

**22. CONTRIBUTIONS TO THE GOVERNMENT**

- a. The share of the National Government from PAGCOR income is computed at 50% of winnings, net of losses after franchise tax, and remitted directly to the Bureau of the Treasury.
- b. Office of the President contribution pertains to the net cash income due to the President’s Social Fund.
- c. The Philippine Sports Commission’s share from PAGCOR income is computed at 5% of winnings, net of losses after franchise tax and Government share.
- d. Cities and provinces hosting the casinos are granted donations/financial assistance in amounts approved by the Board of Directors.
- e. Early Childhood Care and Development Fund represents PAGCOR’s contribution of up to ₱2 billion as mandated by Section 10 of Republic Act (RA) 8980, Early Childhood Care and Development (ECCD) Act of 2000. From calendar year 2003 up to the end of the current year, ₱594,293,528 has been recorded as contributions due to the Council for the Welfare of Children, Office of the President. From the amount due, ₱411,385,631 was already remitted to the Council, leaving the ₱182,907,897 in the Due to Other National Government Agencies (NGAs) account balance at year end. As shown in the revised ECCD Five-Year Indicative Plan submitted by the Council Executive Director for PAGCOR funding, the financial requirements of the ECCD program to fully satisfy the required contribution under the law are shown below:

<b>Year</b>	<b>Amount</b>
2007	₱ 456,273,900
2008	577,732,384
2009	402,196,563
2010	<u>152,411,522</u>
	<u>₱ 1,588,614,369</u>

- f. Gasoline Station Training and Loan Fund (GSTLF) refers to PAGCOR’s contribution of an initial amount of ₱300 million required under Section 10 of RA 8479, Downstream Oil Industry Deregulation Act of 1998. From January 2002 up to the end of the current year, the amount of ₱223,500,000 was recorded as contributions pursuant to this Act, with ₱60,000,000 of said amount already remitted to the GSTLF, and the balance of ₱ 163,500,000 remaining as part of the Due to Other NGAs account balance.
- g. Barangay Micro Business Enterprises refers to PAGCOR’s endowment of ₱300 million under Section 10 of RA 9178, the Barangay Micro Business Enterprises Act of 2002. From January 2004 to December 31, 2006, out of the required endowment, ₱ 148,958,333 was already recorded as due to the Small

and Medium Enterprise Development (SMED) Council. As of balance sheet date, ₱ 60,000,000 was remitted to the SMED Council and the remaining amount of ₱ 88,958,333 is included in the balance of the Due to Other NGAs account.

- h. The Board of Claims' Share from PAGCOR income is computed at 1% of net cash income.
- i. PAGCOR contribution to the National Endowment Fund for Children's Television is provided under Section 12 of RA 8370, Children's Television Act of 1997. The full amount required of ₱ 30 million was already recorded from August 2002 up to the end of this year, but was not yet remitted to the Fund.
- j. Contributions to Other Government Agencies refers to financial and other forms of assistance granted by PAGCOR to national government agencies not falling under any of the subsidies to national government agencies mandated by law.

### 23. DISCONTINUED OPERATIONS

The operations of Casino Filipino – Silahis branch officially ceased on July 31, 2006. The net income of the branch is presented as discontinued operations in the Statement of Income and Expenses in line with Philippine Financial Reporting Standard No. 5 on Non-Current Assets Held for Sale and Discontinued Operations.

The operating results of the discontinued operations are as follows:

Winnings	₱ 1,034,217,829
Other Business Income	20,952,858
Other Income	<u>37,715,738</u>
	1,092,886,425
Expenses	<u>(418,318,198)</u>
<b>Net Income from Discontinued Operations</b>	<b>₱ <u><u>674,568,227</u></u></b>

## A. COMMENTS AND OBSERVATIONS

### 1. Unremitted contributions to various government agencies

- 1.1 In accordance with the Philippine Amusement and Gaming Corporation (PAGCOR) Charter, Presidential Decree No.1869, and other governing laws, a portion of its net earnings are distributed, among others, to the National Treasury, the Philippine Sports Commission, and the Board of Claims. Aside from these, PAGCOR is also mandated to provide funds for certain purposes under the following laws:

Law	Date Approved	Mandated Contribution
RA 8370 - Children's Television Act of 1997	10/28/97	₱ 30 million
RA 8479 - Downstream Oil Industry Deregulation Act of 1998	02/10/98	300 million
RA 8492 - National Museum Act of 1998	02/12/98	250 million
RA 8980 - Early Childhood Care and Development Act of 2000	12/05/00	2 billion
RA 9178 - Barangay Micro Business Enterprises Act of 2002	11/13/02	300 million

- 1.2 Analysis of the subsidy account to the government agencies subject of the above legislative enactments disclosed the following information:

- a. As specified in Section 12 of RA 8370, the amount of ₱30 million from the gross income of PAGCOR shall form part of the National Endowment Fund (NEF) created under the act for the promotion of high standards of indigenous program development in children's television and media specifically intended for Filipino children. Management has already recorded the full amount required by the law from August 2002 until December 2006 but has not yet remitted said amount to the implementing body, National Council for Children's Television.
- b. Pursuant to Section 10 of RA 8479, an initial amount of ₱300 million for a gasoline station training and loan fund is to be provided by PAGCOR to serve as capital for the establishment and operation of gasoline stations. From January 2002 up to the end of the current year, the amount of ₱223,500,000 was recorded as contributions pursuant to this Act, with ₱60,000,000 of the said amount released to the Department of Energy and the balance of ₱163,500,000 remaining as part of the Due to Other National Government Agencies (NGAs) account balance. Unremitted contribution amounts to ₱ 240 million.
- c. Under Section 23.2 of RA 8492, PAGCOR is to provide ₱250,000,000 from its annual net earnings to the National Museum as Museum Endowment Fund (MEF) to be used for its special programs, projects and activities. A total of ₱72,000,000 was already remitted to the MEF from September 2002 up to audit date with the amount of ₱178,000,000 still to be released.

- d. As provided under Section 10 of RA No. 8980, the amount of ₱2 billion shall be appropriated for the Early Child Care and Development (ECCD) program of the National ECCD Coordinating Council to be funded from the gross income of PAGCOR. From calendar year 2003 up to December 31, 2006, ₱594,293,528 was recorded as contributions due to the ECCD Council and out of that amount, ₱411,385,631 was already remitted, leaving the balance of 182,807,897 in the Due to Other NGAs account balance at year-end. Number 22, Notes to Financial Statements, shows the financial requirements of the ECCD program for PAGCOR funding until year 2010.
- e. Under Section 10 of RA 9178, a Barangay Micro Business Enterprises Development Fund shall be set up with an endowment of ₱ 300 million from PAGCOR to be administered by the Small and Medium Enterprise Development (SMED) Council. Out of the required endowment amount, ₱148,958,333 was recorded from January 2004 up to December 31, 2006 as contributions due to the SMED Council. As of balance sheet date, only the amount of ₱60 million was released to the SMED Council with the balance of ₱88,958,333 still part of the Due to Other NGAs account balance.

1.3 We had recommended and management agreed to comply with the provisions of the above-cited laws and remit the mandatory contributions to the concerned government agencies.

## **2. Cash dividends from PAGCOR's net earnings for calendar years 2005 and 2006 not remitted to the National Government**

- 2.1 This matter has been the subject of previous year's audit observations.
- 2.2 Section 3 of R. A. No. 7656 states that "All government-owned and/or -controlled corporations shall declare and remit at least fifty percent (50%) of their annual net earnings as cash, stock or property dividends to the National Government. This section shall also apply to those government-owned and/or -controlled corporations whose profit distribution is provided by their respective charters or by special law, but shall exclude those enumerated in Section 4 hereof: . . ." Likewise, Section 4 of R.A. No. 7656 provides that "The provisions of the preceding section notwithstanding, government-owned and/or -controlled corporations created or organized by law to administer real or personal properties or funds held in trust for the use and the benefit of its members, shall not be covered by this Act such as, but not limited to: the Government Service Insurance System, the Home Development Mutual Fund, the Employees Compensation Commission, the Overseas Workers Welfare Administration, and the Philippine Medical Care Commission." (Underscoring supplied)
- 2.3 Corollarily, the Department of Justice issued Opinion No. 26, s. 2003, dated April 23, 2003, which states that PD 1869 and RA 7656 are two distinct laws and independent from each other. The same opinion ruled that ". . . the share of the National Government under RA 7656 is in the nature of profit which

accrues to the National Government as investor in Government-Owned and/or -Controlled Corporations (GOCCs), whereas in PD 1869, the share of the National Government is in the nature of royalties for the privilege granted by it to the franchise holder in gambling operations.” The royalty referred to therefore is considered as an operating expense, while the basis of the dividends declared under RA 7656 is net earnings. Net earnings defined under paragraph d, Sec. 2 of RA 7656, “shall mean income derived from whatever source, whether exempt or subject to tax, net of deductions allowed under Section 29 of the National Internal Revenue Code, as amended, and income tax and other taxes paid thereon, but in no case shall any reserve for whatever purpose be allowed as deduction from net earnings.”

2.4 Apparently, PAGCOR was not included in the list of exempted GOCCs under the aforementioned Section 4 of RA 7656, neither was PAGCOR organized by law to administer real or personal property or funds held in trust for the use and benefit of its members. However, in spite of the issuance of said opinion by the Department of Justice, PAGCOR has not complied with the requirement stated in Section 3 of RA 7656.

2.5 Management has commented that the gross earnings of PAGCOR go to those deductions mandated by law, its operating expenses, and those required by existing policies, such that, at the end of every month, PAGCOR’s net earnings amount to zero. However, contrary to their claim, PAGCOR’s statements of income and expenses for the years 2005 and 2006 show net income/earnings of ₱2,518,103,583. Of the two years net income, the required dividends to be remitted to the National Government amount to ₱933,539,465, after deducting the thirty five percent (35%) income tax due from the agency. With the enactment of Republic Act No. 9337, an act amending certain sections of the National Internal Revenue Code of 1997, as amended, and for other purposes, the exemption of PAGCOR from payment of corporate income tax was withdrawn effective July 1, 2005.(underscoring supplied) Hence, the fifty percent (50%) cash dividends for two years of ₱933,539,465 was computed as follows:

	<b><u>2006</u></b>	<b><u>2005</u></b>
Net income	₱ 1,648,921,890	₱ 869,181,693
35 % income tax (July to Dec.)	<u>577,122,661</u>	<u>73,901,994</u>
Net income after tax	<u>1,071,799,229</u>	<u>795,279,699</u>
50% dividends	<u>₱ 535,899,615</u>	<u>₱ 397,639,850</u>

2.6 Section 10 and 11 of the Implementing Rules and Regulations of RA 7656 provide, among others, for the responsibility sanctions and criminal liabilities of any member of the governing board, the chief executive and the chief financial officer of a GOCC relative to the non-remittance of the 50% dividends to the National Government as follows:

“ . . . the governing board of the GOCC shall be responsible for approving the declaration of dividends . . . . The chief executive and finance officers of the GOCC shall be responsible for the remittance of dividends based on the declaration made by the governing board

GOCCs which fail to declare and remit dividends . . . shall be assessed a penalty charge for the late payment equivalent to the prevailing 364-day regular Treasury bill rate plus five percent (5%) on the dividend due.”

- 2.7 We have recommended that PAGCOR comply with RA 7656 and its Implementing Rules and Regulations to remit annually the fifty percent (50%) cash dividends to the National Government to avoid penalty charges and criminal liabilities.
- 2.8 Management has commented that “Contrary to what the Department of Justice (DOJ) Opinion No. 26, Series of 2003, provides, PAGCOR is not covered by the provisions of RA 7656.” If it is covered, there is already compliance since at the end of the year, PAGCOR is left with no income after financial obligations and legislative commitments to remit to the National Government is complied with. Nevertheless, Management has filed an appeal on the DOJ opinion for a more definitive ruling on the matter.
- 2.9 On February 28 and September 7, 2006, the PAGCOR Chairman and CEO sent a letter to the President, Malacañang Palace, seeking guidance regarding the proper interpretation of RA 7656 as it is the position of PAGCOR that it is not covered by the said RA 7656. On April 10, 2007, the Executive Secretary referred the PAGCOR letter to the Department of Finance Secretary for comment and advice.

### **3. Car plan benefits not subjected to fringe benefit tax**

- 3.1 Fringe benefit is defined under Section 2.33 (B) of Revenue Regulation No. 3-98 dated May 21, 1998 as “any good, service, or other benefits furnished or granted by an employer in cash or in kind in addition to basic salaries to an individual employee except rank and file employees such as, but not limited to the following:

“ . . . . .  
“(3) Vehicle of any kind;  
. . . . .

“(5) Interest on loan at less than market rate to the extent of the difference between the market rate and actual rate granted.”

Sec. 2.33 (A) of said regulation also provides that “a final withholding tax shall be imposed on the grossed-up monetary value of fringe benefit furnished, granted or paid by the employer, except rank and file employees whether such employer is an individual, professional partnership or a corporation, regardless of whether the corporation is taxable or not, or the government and its instrumentalities. The grossed-up monetary value of the fringe benefit represents the whole amount of income realized by the employee which includes the net amount of money or net monetary value of property which has been received plus the amount of fringe benefit tax thereon otherwise due from the employee but paid by the employer for and in behalf of his employee.”

- 3.2 In addition, Section 2.33 B (3) also states that “If the employer provides with cash for the purchase of a motor vehicle, the ownership of which is placed in the name of the employee, the value of the benefit shall be the entire value of the benefit regardless of whether the motor vehicle is used by the employee partly for his personal purpose and partly for the benefit of his employer, unless the same was subjected to a withholding tax as compensation income under Revenue Regulations No. 2-98.” (Underscoring supplied)

Section 2.33 B (5) further states that “. . . when an employer lends money to his employee free of interest or at a rate lower than twelve per cent (12%), the difference between the interest assumed by the employee and the rate of twelve per cent (12%) shall also be treated as a taxable fringe benefit. This regulation shall apply to installment payments or loans with interest lower than twelve per cent (12%).” (Underscoring supplied)

- 3.3 In determining the amount subject to the fringe benefit tax, “The Tax Code allows for the cases where only a portion (i.e. less than 100 per cent ) of the fringe benefit is subject to the fringe benefit tax as clearly stated in Section 33 (a) of R.A. 8424 which stipulates that fringe benefits which are “required by the nature of, or necessary to the trade, business or profession of the employer, or when the fringe benefit is for the convenience or advantage of the employer” are not subject to the fringe benefit tax. Thus, in cases where the fringe benefits entail joint benefits to the employer and employee, the portion which shall be subject to the fringe benefit tax and the guidelines for the valuation of fringe benefits are defined under these rules and regulations. ”

Furthermore, if there is failure in the payment of fringe benefit tax on due date, a corresponding penalty of twenty five per cent (25%) and interest of twenty per cent (20%) shall be imposed based on Sections 248 and 249, respectively, of the National Internal Revenue Code.

- 3.4 The PAGCOR car plan program was approved by the Board of Directors on March 17, 1987. Such benefit is offered to all permanent full time officers who are occupying a pay scale of PC 9 and above (formerly PC 8 and above). In the initial implementation of the program, the cost of the vehicle was shared by PAGCOR and the officer based on the ratio of forty-five (45) per cent and fifty-five (55) per cent, respectively. On June 13, 2001, the ratio was changed to sixty (60) per cent for PAGCOR and forty (40) per cent for the officer.

Currently, the officer’s counterpart equivalent to 40% of the cost of vehicle or authorized Officer’s allocation under the car plan program whichever is lower, is now payable over sixty (60) equal monthly amortizations for five (5) years except from the position of Vice President for Administration, President and members of the Board of Directors which is four (4) years, without interest. The vehicle acquired is registered in the name of the officer and mortgaged to PAGCOR until fully paid.

- 3.5 For the years 2004 to 2006, PAGCOR disbursed a total of ₱321,750,315 for car plan benefits, broken down below:

<b>Year</b>	<b>Corporate Subsidy (60%)</b>	<b>Employees Share (40%)</b>	<b>Total</b>
2004	₱ 49,629,256	₱ 33,086,171	₱ 82,715,427
2005	63,611,572	42,407,714	106,019,286
2006	<u>79,809,361</u>	<u>53,206,241</u>	<u>133,015,602</u>
	<u>₱193,050,189</u>	<u>₱ 128,700,126</u>	<u>₱ 321,750,315</u>

The amount shouldered by PAGCOR equivalent to 60% (previously 45%) of the cost of the vehicles or the officer's allocation, whichever is lower, and the grant of interest free car loans to officers were benefits which should have been subjected to the fringe benefit tax based on the aforementioned provisions of Revenue Regulation No. 3-98.

- 3.6 It was noted that the car plan benefits granted to PAGCOR officers were not subjected to fringe benefit tax in violation of Revenue Regulation No. 3-98 dated May 21, 1998 in relation to Sec. 33 of Republic Act No. 8424, otherwise known as the National Internal Revenue Code of 1997, and failure to withhold and remit the same will make the withholding agent liable under Sec. 247(b), 251 and 272 (a) and (b).

PAGCOR has not paid ever since for the fringe benefit tax on car plan subsidy and interest free loans including the penalty and interest as required under Revenue Regulation No. 3-98 dated May 21, 1998, thus depriving the National Government of much needed funds to finance its various projects. In effect, non-payment and non-remittance of said taxes also understated the operating expenses and overstated the net income of PAGCOR for calendar years 2004, 2005 and 2006. The fringe benefit tax which should have been imposed on the car plan subsidy and interest free loans amounting to ₱90,381,265 and ₱6,863,470, respectively, or a total of ₱97,244,735, is detailed as follows:

<b>Year</b>	<b>Corporate Subsidy (60%)</b>	<b>Interest Free Loan (40%)</b>	<b>Total</b>
2004	₱23,354,944	₱2,426,961	₱25,781,905
2005	29,934,857	3,037,565	32,972,422
2006	<u>37,091,464</u>	<u>1,398,944</u>	<u>38,490,408</u>
	<u>₱90,381,265</u>	<u>₱6,863,470</u>	<u>₱97,244,735</u>

- 3.7 We reiterate the same recommendation contained in last year's audit report on PAGCOR that the car loan benefits be subjected to fringe benefit tax for immediate remittance to the Bureau of Internal Revenue in compliance with Revenue Regulation No. 3-98 dated May 21, 1998.

- 3.8 Management had commented that a similar issue for the settlement of fringe benefit tax, among others, was submitted to the Department of Justice (DOJ) for administrative settlement or adjudication. The DOJ, in PAGCOR versus the Bureau of Internal Revenue, et. al., docketed as OSJ Case No. 2004-1, declared that PAGCOR is exempt from payment of all taxes. The DOJ further declared that ". . . (t)he intent of the law to grant petitioner preferential exemptions from all forms of taxes, duties, fees, imposts cannot be doubted. The rationale for this grant of preferential exemptions can be attributed to the undeniable contribution of the petitioner to the revenue of the government."

- 3.9 COA holds its position that the car plan benefits of PAGCOR officers are subject to fringe benefit tax. DOJ opinion is only persuasive at the moment until such time that the petition for certiorari with prohibition filed by PAGCOR with the Supreme Court under GR No. 172087 is resolved.

#### 4. No approval from the Office of the President of the increased car plan benefits

- 4.1 Malacañang Memorandum Order (MO) No. 20 dated June 25, 2001 directed the Heads of GOCCs, GFIs and Subsidiaries exempted from or not following the Salary Standardization Law (SSL) to implement pay rationalization in all senior officer positions. Section 1 of said memorandum requires immediate suspension of the grant of any salary increases and new or increased benefits such as, but not limited to, allowances; incentives; reimbursement of expenses; and such other benefits not in accordance with the SSL covering senior officer level positions, including members of the Board of Directors or Trustees. Section 2 of same MO No. 20 requires the preparation of the Pay Rationalization Plan for senior officer positions and members of the Board of Directors/Trustees, while Section 3 provides that any increase in salary or compensation of GOCCs/GFIs that are not in accordance with the SSL shall be subject to the approval of the President.
- 4.2 Section 6.0 of the Memorandum dated July 13, 2001 from the Executive Secretary to all Heads of GOCCs, GFIs and Subsidiaries regarding Pay Rationalization Plan provides that members of the Board of Directors/Trustees of GOCCs shall be guided by the maximum rates prescribed under Memo Circular No. 40 dated April 5, 1993 and that no other benefits, in cash or in kind, shall be allowed. However, in cases where the existing rates are below the maximum provided under MC. 40, any proposed increase shall be subject to the approval of the President.
- 4.3 Also, Malacañang Administrative Order (AO) No. 103 dated August 31, 2004, duly published in the Official Gazette, directed the continued adoption of austerity measures in the government. Section 3 thereof states that "All NGAs, SUCs, GOCCs, GFIs and OGCEs, whether exempt from the SSL or not are hereby directed to: . . . suspend the grant of new or additional benefits to full-time officials and employees; . . ." Section 5 of same AO 103 further states that "Heads of NGAs and SUCs, as well as the governing boards of GOCCs GFIs and OGCEs shall be responsible for the strict implementation of Memorandum Order No. 20 dated June 25, 2001 and this Order." The AO emphasized that any violation thereof shall be dealt with accordingly.
- 4.4 In a letter dated June 9, 1993 from the Office of the President to the then PAGCOR Chairman and CEO, it is stated that "After a circumspect study, please be informed that **Section 16, Title VI of PD 1869 has been revoked/repealed with the formal promulgation of the 1987 Constitution and R.A. No. 6758**, the Salary Standardization Law (SSL). Accordingly, the request for the approval and confirmation of the authority of the PAGCOR Board of Directors to set/prescribe the compensation package of its officials and employees cannot be countenanced."

**Paragraph 1** of the letter states that “Inasmuch as in the terms of basic salary the obtaining rate in PAGCOR is at par with what has been prescribed under RA 6758 for comparable positions in other GOCCs/GFIs, all PAGCOR positions will be classified and allocated salary grade in accordance with the Index of Occupational Services approved for GOCCs/GFIs pursuant to R.A. No. 6758.” **Paragraph b** further states that “Thereafter, no further increase in basic allowances, and all other forms of compensation shall be granted/implemented without prior approval of the President based on the recommendation of the Department of Budget and Management.”

- 4.5 The car plan benefit was granted to PAGCOR officers with the objective of providing them with a presentable means of transportation in the conduct of official transactions with private and/ or public offices to project a favorable image for the corporation. Moreover, the car plan was made available to afford officers the opportunity to acquire a vehicle of their choice under reasonable/easy terms. The car plan, which was implemented since 1987, was last approved by the Office of the President on August 15, 2000. At that time, the sharing on the cost of the vehicle was forty five (45%) percent subsidized by PAGCOR and the remaining fifty five (55%) percent shouldered by the officer and paid in equal monthly installments for five years with zero interest.
- 4.6 Upon approval by the Board of Directors on June 13, 2001, the **new sharing scheme of forty (40%) percent to be shouldered by the officer and the sixty (60%) percent to be subsidized by PAGCOR, as well as the increase in the amount of benefit were implemented without approval by the Office of the President.** The increase in the benefit is as follows:

Salary Scale	Increase	
	From	To
PC 8 & 9	650,000	800,000
PC 11 & up	800,000	1,100,000
Board of Directors	900,000	1,300,000

Effective July 2006, the benefit has been increased to:

Salary Scale	Amount	Term of Payment
PC 9-10	950,000	5 years
PC 11-13	1,250,000	
Chairman	2,650,000	4 years
Board of Directors/President/ Chief Operating Officer/ Vice-President for Adm.	2,150,000	

- 4.7 Incidentally, a review of the remuneration received by the Directors/Principal Officers in the past six (6) years revealed that officers who availed of the car plan benefits still receive transportation allowances (TA) and the amount of TA even increased during the year. Further, it was observed that principal officers who availed themselves of the car plan benefits also use PAGCOR vehicles which is not in accordance with Section 361 of the Government Accounting and

Auditing Manual, Volume I, prescribing regulations on the use of government motor vehicles.

- 4.8 We have recommended that management secure the approval of the Office of the President on the increase of car plan benefit.
- 4.9 Management has commented that PAGCOR's car plan benefit is different from the normal or regular acquisition of motor vehicles of regular national government agencies which requires recommendation of Department of Budget Management Secretary and the approval of the Office of the President, while car plan benefit is part of the employees' benefits which would require board approval only. Granting that the presidential approval is necessary, the original car plan itself had been approved and any increase thereof would only require board approval as it concerns personnel benefits, which is within the powers of the Board to approve.
- 4.10 After their review of the above cited laws, rules, and regulations, Management has further commented (a) that it recognizes the executive issuances relative to the pay rationalization plan of GOCCs consistent with the austerity measures being adopted by the government, but it is their position that the Board of Directors of PAGCOR is in a better position to determine the fiscal position and direction of the company; (b) that while they are not trying to create an "emporium in emperia," PAGCOR enjoys fiscal and financial autonomy; (c) that pursuant to the business judgment rule, PAGCOR Board of Directors determines business decisions considered best and advantageous to the interest of the company; and (d) that the decision of the Board to increase the car plan benefit of its officers is pursuant to its judgment consistent with the charter that the same would redound to the best interest of the company.
- 4.11 COA reiterates its recommendation to seek approval of the increase in car plan benefit from the Office of the President based on the above requirement.

## **5. Conduct and operation of the e-bingo not covered by duly notarized contract**

- 5.1 Article 1356 of the New Civil Code states that "Contracts shall be obligatory, in whatever form they may have been entered into, provided all the essential requisites for their validity are present. However, when the law requires that a contract be in some form in order that it may be valid or enforceable, or that a contract be proved in a certain way, that requirement is absolute and indispensable. In such cases, the right of the parties stated in the following article cannot be exercised." (underscoring ours) A contract is a meeting of minds between two persons whereby one agrees to give something or to render some service to another for a consideration. There is no contract unless the following requisites concur: (a) consent of the contracting parties; (b) an object certain which is the subject of the contract; (c) the cause of the obligation which is established (Cathay Pacific Airways, Ltd. Vs. Vasquez, 399 SCRA 207).
- 5.2 No contract shall arise unless its acceptance is communicated to the other (Insular Life Assurance Company, Ltd. Vs. Asset Builders Corporation, 422

SCRA 148). When there is absolutely no acceptance of an offer or if the offer is expressly rejected, there is no meeting of the minds (National Housing Authority vs. Grace Baptist Church, 424 SCRA 147). The consent by a party is manifested by the meeting of the offer and the acceptance upon the thing and the cause which are to constitute the contract; an offer that is not accepted does not give rise to a consent. Unless the offeror knows of the acceptance, there is no meeting of the minds of the parties, no real concurrence of offer and acceptance; contract is perfected only from the time the acceptance of an offer is made known to the offeror; an acceptance which is not made in the manner prescribed by the offeror is not effective but constitutes a counter-offer which the offeror may accept or reject; acceptance by the offeree after knowledge of the revocation or withdrawal of the offer is inefficacious. (Malbarosa vs. Court of Appeals, 402 SCRA 168).

- 5.3 Notarization by a notary public converts a private document into a public one, making it admissible in evidence without the necessity of preliminary proof of its authenticity and due execution (Heck vs. Santos, 423 SCRA 329). A document acknowledged before a notary public enjoys the presumption of regularity and it is a prima facie evidence of the facts therein stated (Medina vs. Greenfield Development Corporation, 423 SCRA 150).
- 5.4 The conduct of electronic bingo (e-bingo) games started since 2002 and it generated a gross revenue of ₱2,341,746,607 as of December 31, 2006. Electronic bingo grantees remitted ₱1,287,926,338 as PAGCOR share and ₱117,083,043 as franchise tax or a total amount of ₱1,405,009,381. E-bingo operation was authorized under a letter/ notice to operate and conduct an electronic bingo, signed by the Managing Head, Bingo Department. In the notice, it states that the Board of Directors approved/confirmed the grant of the grantees' authority to operate and conduct e-bingo games. The notice also states the rights and obligations of the bingo grantee. A total of 44 venues was approved to be operated, however, the authorized bingo operators in only five venues (Elizabeth Mall-Cebu City, SM City-Cebu City, SM Mall of Asia, SM City-Davao and Ever-Gotesco Commonwealth) signed their conformity in the notice.
- 5.5 As stated in the Memorandum dated October 16, 2006, issued by the Acting Managing Head of Bingo Department, there is no other contract or agreement executed by PAGCOR relative to the grant of authority to conduct electronic and rapid bingo games. In the absence of such documents, enforcement of the terms and conditions required by both PAGCOR and the e-bingo grantees might not be facilitated.
- 5.6 We have recommended that Management execute a formal contract or memorandum of agreement between PAGCOR and the other 39 bingo grantees for faithful compliance of its agreement.
- 5.7 Management commented that the draft of Supplemental Grant of Authority (SGOA) to operate e-bingo games had been reviewed by the Corporate Legal Services Department. The Bingo Department will issue the SGOA to the grantees immediately upon approval thereof by the Board of Directors.

## **6. Erroneous recording and unrecorded issuances of chips and tokens**

- 6.1 Under Philippine Accounting Standard (PAS) 2, “Inventories are assets in the form of materials or supplies to be consumed in the production process or in the rendering of services.”
- 6.2 Likewise, paragraph 38 of the Framework for the Preparation and Presentation of Financial Statements states that:

“To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.”
- 6.3 In the 2005 AAR, Management agreed to implement COA’s recommendation to reclassify the chips and tokens recorded in 2005 as Other PPE – Chips and Tokens to Other Supplies Inventory – Chips and Tokens account.
- 6.4 It was noted that Management up to now has not reclassified the Other PPE – Chips and Tokens account to Inventory. The acquisition for 2005 of ₱12,145,523 and the acquisition for 2006 of ₱19,674,042 comprised the ending balance of ₱31,819,565 of the Other PPE – Chips and Tokens account as of December 31, 2006. The issuances of chips and tokens to the casino branches, however, were not recorded in the books.
- 6.5 In the interview of concerned personnel, it appears that there is adequate control in the handling of chips and tokens in casino branches. The accountable officers are required to prepare and submit regularly the Branch Accountability Report, showing the total cash and the face value of chips and tokens required as a fixed working fund for casino gaming operation. The amount of cash and chips and tokens on hand of the accountable officer varies from time to time, but the total amount should tally with the total working fund in the Branch Accountability Report, which is prepared every shift by the accountable officer.
- 6.6 The Treasury Fund Capital account per general ledger and the total face value of the chips and tokens as disclosed in the Notes to Financial Statements should tally with the total accountability of the accountable officers per Branch Capital Accountability Reports, for monitoring purposes.
- 6.7 Nonetheless, Management believes that the need to establish accountability can already be satisfied with the monthly Branch Accountability Report submitted by the Branch Treasury to COA. The physical inventory of chips and tokens is reconciled regularly with the records of Corporate Treasury Division and accountable officers (AOs). The AOs are then required, for monitoring purposes, to submit monthly reports of Accountability for Chips and Tokens.

- 6.8 We reiterate our previous year's recommendation that Management reclassify the Other PPE – Chips and Tokens to Other Supplies Inventory. It has also been suggested that the Due to and Due from accounts be used to record the issuance of chips and tokens by the Corporate Office to the casino branches.
- 6.9 Management commented that they will comply with the recommendation.

## CORPORATE AND CASINO FILIPINO BRANCHES

### **7. Deposit and advance rental paid for the proposed Hotel-Casino and Sports Complex project at Sta. Rosa, Laguna**

- 7.1 Section 2 of PD 1445 states that it is the declared policy of the state that all resources of the government shall be managed, expended or utilized in accordance with laws and regulations, and safeguarded against loss or wastage through illegal or improper disposition, with a view to ensuring efficiency, economy and effectiveness in its operations. The responsibility to ensure that such policy is faithfully adhered to rests directly with the chief or head of the government agency concerned.
- 7.2 In 2005, PAGCOR entered into a Contract of Lease with a proponent, to lease the property located at Sta. Rosa Laguna for the purpose of conducting, undertaking, and carrying out casino, hotel and related operations. The leased premises covered an area of about 14,845 square meters and the contract is for a period of three years beginning eight months from the date of actual turnover of the property, or until July 11, 2008, whichever comes earlier. The PAGCOR franchise which ends July 11, 2008 was renewed by Congress up to July 11, 2033. As part of the agreement, on October 18, 2005, PAGCOR Corporate Office paid the lessor an advance rental of P33 million, equivalent to six months rental and an additional P33 million on December 29, 2005 for security deposit, also equivalent to six months rental, upon turnover of the property.
- 7.3 However, the project construction, which was supposed to start in the 2<sup>nd</sup> quarter of CY 2006, was stopped after payment of security deposit. Query with the Administration and Senior Managing Head, Research and Development Department (RDD), disclosed that after the failed contract of lease, PAGCOR is in the process of entering into a contract of sub-lease with another contractor where the latter shall lease the hotel-casino and sports stadium complex at Sta. Rosa, Laguna, from the proponent and undertake the development of the said complex, including the casino facility in preparation for sub-lease by PAGCOR. They further commented that upon execution of the aforementioned contract of sub-lease, a request will be sent to the proponent for the return of the advances that PAGCOR has made to them as prescribed in the contract of lease dated October 4, 2005. Details as to why the progress of project implementation stopped was not clearly stated in their reply.
- 7.4 It should be noted that after PAGCOR paid an advance rental in October 2005, when the proponent offered to sell the subject property to PAGCOR and other interested parties, PAGCOR was given the right of first refusal should there be a decision to sell the property during the term of the lease. Said action at that time may be considered as an indication that the risk of non-compliance with the agreement is inevitable. However, instead of initiating moves to void the lease agreement or pre-terminate the contract, due to the said violations of the agreement, PAGCOR has decided to enter into a sub-lease agreement with a third party.

- 7.5 Apparently, there was no viability study done before undertaking this project, hence, the indecision to implement the same. The continued delay in the project implementation is disadvantageous to PAGCOR in terms of opportunity loss where the corporation could have generated additional earnings had operations at the Sta. Rosa, Laguna, project started in August 2006.
- 7.6 We have recommended for Management to exert effort for the recovery of the P66 million security deposit and advance rental payments with full interest. We also suggested that Management enter into contracts only after preparing a viability study on proposed projects.
- 7.7 Top management acknowledged that they partly caused the delay of the project because they entertained other parties. However, they averred that the project will be implemented with another proponent under the same terms and conditions.

#### **8. Refundable security deposit on surrendered leased area at the Casino Filipino Cebu not returned to PAGCOR**

- 8.1 The supplement dated December 30, 2003 to the amended contract of lease by and between the Casino Filipino (CF) Cebu, lessor, and PAGCOR, lessee, provides that: (a) PAGCOR is required to pay the amount of ₱ 157,098,312 to the lessor as refundable security deposit on the leased area of 10,390.10 square meters. The whole amount was also considered as a guarantee to secure PAGCOR's full and faithful performance of each and every term, provision, covenant and condition of the amended contract of lease; (b) That either party may request for a review and adjustment of the area under lease, giving due regard to what is reasonable and justifiable in the light of circumstances obtaining and with primary consideration to the continued viability and level of profitability of both the Hotel and the Casino operations; and (c) That starting January 1, 2005, PAGCOR has the sole option to increase or decrease the leased area covered by the amended contract of lease.
- 8.2 It was noted that the refundable security deposit of ₱ 34,269,480 on the leased area surrendered to the lessor has not been returned to PAGCOR. Records disclose that on February 17, 2005, Casino Filipino Cebu had formally surrendered 1,094.87 sq. m. of basement area to the lessor effective March 1, 2005 and another area of 1,171.63 sq. m. at the 5th level chip washing operation on May 31, 2006. The lessor has not returned the security deposit equivalent to the surrendered area of 2,266.5 sq. m. at ₱1,260/sq.m. for 12 months or a total of ₱34,269,480. Inquiry revealed that, as of audit date, there is no official action by Management to enforce recovery of the security deposit from the lessor despite regular payments of monthly rentals and improvements worth ₱ 20 million.
- 8.3 We have recommended that Management deduct the amount of ₱34,269,480 from subsequent payments to the lessor and to consider enlisting legal assistance in enforcing collection of the refundable amount.

- 8.4 Management agreed to take appropriate legal action against the lessor as a matter of last resort to enforce recovery of the security deposit for the surrendered area.

**9. Actual marketing expenses of CF Airport for calendar year 2006 exceeded budgeted amount**

9.1 Section 5 of PD No. 1177, the Budget Reform Decree of 1977, states that the finances of government shall be analyzed and determined as the aggregate of revenues, expenditures and debts of all units of government, including the national government and its agencies and instrumentalities, local government units and government-owned or controlled corporations. The present budgeting system was designed to achieve the following principal objectives:

- a. to implement government program, projects and activities spelled out in the development plans under a comprehensive fiscal plan developed, authorized and executed in accordance with law and principles of sound public management, and
- b. to provide a means by which government, its instrumentalities and officials, may be held accountable for its actions.

Under the Procedures in Monitoring of the Approved Budget of the National Government Accounting System (NGAS) manual, a summary of the utilization of the approved corporate budget shall be prepared at the end of each month through the Statement of Budget Utilization (SBU).

9.2 A comparative analysis of the actual income and marketing expenses, vis-a-vis projected/budgeted amounts for the year 2006 is shown below:

	<b>Marketing Expenses</b>	<b>Net Winnings</b>
Actual	266,499,753	2,616,869,571
Budget/Projection	192,192,043	3,020,151,315
Variance	74,307,710	( 403,281,743 )
Percent %	38.66%	(13.35%)

From the above analysis, it is seen that while actual marketing expenses exceeded budget by 38.66% or ₱74,307,710, actual winnings fell short of projection by 13.35% or ₱403,281,743 for calendar 2006. In addition, marketing expenses increased in 2006 by 20.70% as compared to 2005 while net income decreased by 2.33% as follows:

	<b>2006</b>	<b>2005</b>	<b>Increase/(Decrease) Amount</b>	<b>%</b>
Marketing Expenses	266,499,753	220,791,730	45,708,023	20.70%
Net Income	1,631,704,298	1,670,583,653	(38,879,355)	( 2.33%)

- 9.3 We have recommended that Management have an approved supplemental budget to rectify the excess of actual marketing expenses against budget. It was also proposed that the Statement of Budget Utilization be prepared as of the end of each month for proper monitoring and control of said expenses.
- 9.4 Management replied that a massive marketing campaign was done to entice more customers, including the introduction of new games, increase in food and beverage amenities, enhancement of foreign rebate program for availees, increase in slot machine promo items, increase in plane fares of VIP guests and reclassification of the salaries of cocktail attendants to marketing expenses.

#### **10. Non recognition of income and liability from Keno game operations at Metro Manila CF branches**

10.1 The New Government Accounting System (NGAS) requires that government owned and/or controlled corporations (GOCCs) shall adopt the following methods of recording income:

- “1. Accrual Method – Accrual Method of accounting shall be used by GOCCs when income is realized (earned) during the accounting period regardless of cash receipt. Accounts receivable is set up and the general or specific income accounts according to the nature and classification are credited.
- “2. Cash Basis – Cash basis of accounting shall be used for other revenues when accrual method is impractical. The income account is credited upon collection. ”

10.2 On June 17, 2004, PAGCOR entered into a Memorandum of Agreement (MOA) with an Australian proponent, to operate the Keno Game for all existing Metro Manila casinos that are wholly-owned and capitalized by PAGCOR as of the date of the Agreement. The Keno Game is a fixed odds numbers game similar in form to lotto, which has the advantage of rewarding its winners based on a predetermined prize scale irrespective of the number of players for a given game. On September 20, 2005, the MOA was amended as follows:

“Sec. 2.1 Section II.1:

- 1) In consideration of this Agreement, . . . shall be entitled to FORTY PERCENT (40%) of the Keno Game’s gross winnings after the FIVE PERCENT (5%) Franchise Tax has been deducted subject to the following conditions:
  - A. PAGCOR’s revenue from the conduct of the Keno Game shall be equivalent to SIXTY PERCENT (60%) of the Keno Game’s gross winnings after the FIVE PERCENT (5%) Franchise Tax has been deducted or a guaranteed monthly minimum of TWO MILLION PESOS (₱2,000,000.00) whichever is higher.

B. If SIXTY PERCENT (60%) of the Keno Game's gross winnings after FIVE PERCENT (5%) Franchise Tax has been deducted is less than ₱2,000,000.00, . . . shall reimburse PAGCOR the difference between guaranteed minimum and actual revenue (Gross wins x 95% x 60%)."

10.3 PAGCOR's guaranteed monthly minimum revenue was decreased from ₱3 million in the original MOA to ₱2 million in the aforementioned amendment. Data gathered from Performance Reports of the three PAGCOR wholly- owned Metro Manila Casino Filipino branches disclosed that the Keno Game revenue, exclusive of winnings during its initial operation in November and December 2005, amounted to only ₱3,430,380 at the end of 2006. Said revenue was way below the total minimum guaranteed revenue of ₱24 million during said year. As such, the difference between the total minimum guaranteed revenue and the actual revenue of ₱3,430,380 (*Gross wins x 95% x 60%*), plus the 6% annual escalation of ₱120,000 provided under Section II.5 of the original MOA, amounted to an income deficiency of approximately ₱22,164,683, as shown below:

60% PAGCOR share (₱3,430,380.00 x 60%)	₱ 1,955,317
Minimum revenue guarantee (₱2 million x 12 months)	24,000,000
Income deficiency (₱1,955,317 minus ₱24 million plus ₱120,000)	22,164,683

10.4 Further review disclosed that the above income deficiency for calendar year 2006, and that for November and December 2005 were not reimbursed by the proponent to PAGCOR. Likewise, the concerned Casino Filipino branches did not recognize in their books the deficiency income earned in 2006 and 2005 and the corresponding receivable from the Australian proponent in accordance with the accrual method of accounting per NGAS.

10.5 On the other hand, the Keno Game revenue was recorded by the Metro Manila Casino Filipino branches at gross winnings. In 2006, the 40% proponent's share, net of 5% franchise tax amounted to approximately ₱1,303,544. The proponent's share in 2006 and 2005 was not recognized as liability during the said period.

10.6 The Metro Manila Casino Filipino branches furnish PAGCOR Corporate Office the data on daily deposit of Keno game winnings as well as the game's monthly revenue performance. Thus, the Corporate Office is well informed of the game's performance from its inception in November 2005.

10.7 However, no recommendation was made by the Coporate Office to recognize the income deficiency as a valid claim against the proponent as well as recognize the liability pertaining to the 40% share of the proponent. Hence, the unrecorded income deficiency understated the receivables and income of the Casino Filipino branches by approximately ₱22,164,683. At the same time, the unrecorded share of the proponent amounting to ₱1,303,544 understated the liability account as at year end.

- 10.8 Management clarified that the guaranteed monthly minimum income from the Keno operation has been adjusted by the PAGCOR Board approval dated March 7, 2006 from ₱2 million to ₱1 million, retroactive from the start of operation due to the following:
- a. Keno game has not generated the patronage and interest originally anticipated; and
  - b. Certain adjustments to the operations set-up of the game were made, effectively decreasing some of PAGCOR's project deliverables such as area to be leased, staffing requirements and gaming consumables.
- 10.9 On January 16, 2007, the Board approved another modification of the guaranteed monthly minimum of ₱1 million to fixed costs, the forfeiture of the proponent's forty percent (40%) share in the net revenue generated by the Keno Game for the period November 29 2005 to May 31, 2006 and the deduction of ₱372,006.59 from the ₱10 million performance bond posted by the proponent. As stated in the letter dated January 18, 2007 of the Vice President – Administration and Senior Managing Head, Research and Development Department, to the Principal of the Australian proponent, the latter concurred in his letter dated January 8, 2007 that the guaranteed minimum monthly income will be equivalent to the monthly "fixed" costs for space rental, utilities, telecommunications and server room consumables plus actual manpower expenses with 10% administrative cost applied to the actual manpower expenses, retroactive from the start of the Keno operation.
- 10.10 The data furnished by Management show that during the first six-month reckoning period, from November 29, 2005 to May 31, 2006, the total receivables of PAGCOR based on the above-mentioned modifications amounted to ₱2,863,087 while the PAGCOR share from the proceeds of the game amounted to ₱1,494,678. Adjustments in the fixed costs for the 2<sup>nd</sup> six-month reckoning, from June 2006 to November 2006, were approved by the Board on February 14, 2007 due to the closure of Casino Filipino Silahis and the increase in space rental fee of Airport Casino Filipino effective September 2006.
- 10.11 Based on Management's clarifications, we have recommended that the significant modifications of the guaranteed monthly minimum income as approved by the PAGCOR Board be duly:
- a. recorded as receivable from the proponent and as adjustment in the affected expense accounts during the period incurred; and
  - b. documented by an amended agreement signed by the Australian contractor and PAGCOR.
- 10.12 Management's efforts to at least recover the costs incurred in the Keno game operation is a step in the right direction, however, it is in the best interest of PAGCOR that similar undertakings in the future undergo careful study/review and even test runs, if necessary, to avoid loss of income.

## **11. Absence of a penalty clause in the MOA with the Australian proponent of the Keno game**

11.1 Review of the Memorandum of Agreement (MOA), as amended, with the Keno game Australian proponent disclosed that it has no penalty clause provision in case the proponent incurs delay in the reimbursement of revenue deficiency as agreed upon. The absence of a penalty clause provision in the MOA may have encouraged the non-reimbursement of approximately over ₱ 22 million in 2006 and 2005 arising from revenue deficiency in the guaranteed monthly minimum income of ₱2 million provided in the MOA. Moreover, PAGCOR cannot penalize the proponent for delay in payment, and neither can they enforce that a percentage of the unpaid amount be imposed as penalty charge.

11.2 In order to protect the interest of PAGCOR and encourage the proponent to promptly reimburse incurred revenue deficiency, it was suggested that Management incorporate a penalty clause in the Memorandum of Agreement.

11.3 Management agreed to comply with the recommendation.

## **12. Non-reclassification of completed projects, improvements or constructions to proper asset account at CF Manila Pavilion**

12.1 The Philippine Government Chart of Accounts, under the New Government Accounting System (NGAS) per COA Circular 2003-001 dated June 17 2003 and 2004-002 dated April 29, 2004, describes *Construction in Progress* as the cost/appraised value of government assets which are still under construction including software development. During construction period, the asset is to be classified and recorded as "Construction in Progress". As soon as the construction is completed, the "Construction in Progress" account shall be transferred to the appropriate asset account.

12.2 Verification showed that the balance of the Construction in Progress account of ₱123,151,437 as at year end consisted of the expenses incurred for casino renovations. As at end 2006, constructions/renovations of the Manila Pavilion casino were fully completed as described below:

a. Façade Border Light Emitting Diodes;

PAGCOR and a contractor, in a Memorandum of Agreement (MOA) dated April 5, 2006, agreed to jointly undertake the commissioning and construction of the Manila Pavilion façade border light emitting diodes. Both parties agreed to equally share the cost of the project amounting to ₱11,000,000. PAGCOR remitted its share in the amount of ₱5,500,000 to the contractor upon the signing of the MOA.

b. Canopy and driveway fronting the casino entrance; and

c. Other improvements in the leased area of the casino.

- 12.3 Audit disclosed that the cost of these completed projects/constructions/improvements are still included in the balance of the Construction in Progress (264-00) account as of December 31, 2006, resulting to the understatement of Leasehold Improvement account and its corresponding accumulated amortization/amortization expense.
- 12.4 We have recommended that management reclassify the cost of the completed projects/constructions/improvements to Leasehold Improvements–Casino Building and amortize the same over the life of the improvements or lease term, whichever is shorter.
- 12.5 According to Management, the commissioning of the façade border light emitting diodes was almost completed in the second week of December. As of audit date, the said project was not formally turned over to them. They will make the necessary adjustments as soon as they receive the complete documents. The refurbishing of the canopy and driveway was part of the whole casino renovation. Pavilion casino management is still awaiting the final list of expenses from Corporate Office to be debited to them for final reclassification.
- 12.6 We reiterate our recommendation and advise Management to hasten the documentation of expenses. The delay in the documentation and finalization of expenses incurred on completed projects/constructions/improvements could have been avoided had the expenses been apportioned based on renovation plans per floor/area.

**13. Absence of a penalty clause provision in agreements/contracts entered into by CF branches**

- 13.1 Agreement with a company, thru its franchisee, to operate a coffee shop at CF-Pavilion
- a. It was noted that the coffee company's rental payment performance showed the concessionaire's inability to pay fully their obligations to the CF-Manila Pavilion on time as agreed upon in the Addendum to Agreement. It was noted that in the 2<sup>nd</sup> year of the sub-lease, delays in rental payments were between 5 to 319 days, until such time that these had been fully paid. The full collection of rentals for the months of July to December 2006 had been overdue by 3 to 179 days.
  - b. Further review showed that the concessionaire has not remitted the 3% PAGCOR share on cash sales from non-PAGCOR transactions for the month of October 2006, as provided under the Addendum to Agreement, paragraph 1 on RENTALS.
  - c. The absence of a penalty clause in the Agreement may have encouraged the violations cited above. The CF- Manila Pavilion cannot penalize the concessionaire for mere delay in payment and neither can they enforce that a percentage of the unpaid amount serve as penalty charge.

- d. In order to protect the interest of PAGCOR and encourage prompt rental payments, it was advised that Management consider amending the Agreement to incorporate a penalty clause provision.

### 13.2 Contract to conduct chip washing operation at CF-Heritage

- a. On October 6, 2000, PAGCOR entered into an Agreement with a certain company granting the latter the privilege to conduct chip washing operation at the CF-Heritage. The original Agreement, which expired on March 31, 2002, was later extended to March 31, 2003, and further extended to March 31, 2006. After the latter date, the contract was renewed on a month-to-month basis awaiting finalization of the contract with a new proponent for chip washing operation.
- b. In consideration of the privilege granted to conduct chip washing operation, the original contract provided that the contractor pay PAGCOR a minimum guaranteed share in the amount of US\$150,000 (or its equivalent in Peso) per month, or 10% of the gross winnings computed every six months, whichever is higher. Later, in November 2002 this minimum guaranteed amount was increased to US\$160,000 or 10% of the gross winnings whichever is higher, on account of the expanded chip washing operation. As provided further in the contract, the amount of PAGCOR share in the chip washing operation for the month shall be payable on the first week of the following month.
- c. While the contract provided for a due date in the payment of the minimum monthly guaranteed share of PAGCOR which is on the first week of the following month, it failed to provide a penalty clause for late payment. Records show that the chips washing operation contractor has been habitually delayed in its monthly payments. Had a provision for penalty charges for late payment been provided in the contract similar to that provided in another contract for chip washing operation, PAGCOR could have earned additional income in the amount of ₱ 329,353, assuming an interest rate of 1% per month or a fraction thereof. This rate is the existing penalty rate imposed upon another chip washing operator.
- d. We have recommended that in the absence of a provision for imposition of penalty charges for late payment of the guaranteed monthly PAGCOR share of US\$160,000, Management find ways to ensure timely collection of the amount from the proponent.
- e. In the on-going negotiation with the new proponent for chip washing operation, it is suggested that a penalty clause for late payment of PAGCOR share be included.
- f. CF-Heritage management commented that it is not in a position to review the contract with the chip washing operator, hence, the issue above and COA's recommendation was referred to top management under a Memorandum dated February 27, 2007 for consideration.

**14. Sharing scheme of the accumulated 40% jackpot meter increment not explicitly stated in contract**

14.1 A domestic private corporation entered into a contract with PAGCOR to deliver and install DEQ Progressive Electronic Gaming Equipment at selected Casino branches. In accordance with the agreement, PAGCOR will manage and directly operate electronically metered progressive side betting together with the regular table games. The contractor is to provide a seed money of ₱1,500,000 (1 million for Stud Poker/.5 million for Pai-gaw) as initial jackpot prize and a standby reserve fund of ₱100,000 per table to compensate for the difference whenever the jackpot meter amount would fall below the seed money. Similarly, the contractor shall issue signed/undated checks, held for safekeeping by the Finance Officer, for immediate replenishment of the seed money in the event that the whole of the jackpot has been won.

14.2 PAGCOR opened a bank account under the name of the contractor as depository for seed money, standby reserve fund and monthly 40% meter increment.

The rules and regulations on jackpots, including payout schemes, prizes and the amount of side bets shall be conceptualized by PAGCOR.

For directly managing and operating the progressive electronic gaming equipment, PAGCOR shall receive sixty percent (60%) of the net revenue. The remaining forty percent (40%) less franchise and all other applicable taxes shall go to the contractor. Net revenue is defined as gross revenue less the total amount (40% jackpot meter increment) allocated for payouts of jackpot prize and pertinent taxes due thereon. Gross revenues are also defined as the total side bets or gross side bets made on the progressive circle of all table games using the equipment.

In the event that the contractor will terminate the contract, the present terms of the contract are not clear and specific as to ownership and sharing arrangement for the accumulated increment.

14.3 We have recommended to consider amendments on the terms of the contract to ensure that the sharing arrangement for the accumulated increment for jackpot prize is properly defined in the event of termination or dissolution.

14.4 Also, in consultation with the contractor, have the ownership of the accounts rectified by changing the bank account name in favor of PAGCOR to facilitate payment of jackpots and to avoid future legal problems over the disposition of the account balance in the event of termination.

**15. No formal contract with food and beverage concessionaire at CF Hyatt**

- 15.1 A food chain was contracted by the Casino Filipino Hyatt Manila (CF-Hyatt) lessor to operate the employees' canteen at the casino pursuant to Section 11.2 of the lease agreement. Due to its reasonable rates, per the branch's evaluation, the food chain was commissioned to supply the daily buffet meals and snacks for casino customers as part of the amenities for loyal patrons. The food chain was accredited by CF-Hyatt as a food and beverage (F&B) concessionaire. However, it is believed that mere accreditation is not as binding as a formal contract or agreement which has the force of law between the parties, binding them to faithfully comply with its provisions.
- 15.2 We have recommended that a contract be executed by the food chain and CF Hyatt for the supply of food and beverage to casino patrons and customers. It was also proposed that the contract to be drawn by the parties contain the essential elements and characteristics of a contract in general in order to create a binding and enforceable effect.
- 15.3 CF-Hyatt Management deems that a separate contract, between PAGCOR/CF-Hyatt and the F&B concessionaire operating inside the casino, is essential to protect PAGCOR, its employees, customers, guests and property from harm/damage or risk to life, limb or property that may arise from improprieties, unlawful behavior, negligence, incompetence, carelessness, etc. of the said concessionaire or its employees. It was also informed that a draft contract had been prepared by the branch to be sent to the Corporate Legal Services Department for routine review. After such review, the contract is to be confirmed by an authorized PAGCOR officer before it is signed by the contracting parties.

## **16. No discounts on buffet meals served to casino patrons**

- 16.1 It is a practice in a majority, if not all the PAGCOR casinos, that their concessionaires offer discounts of from 10% to 20% on the food and beverages served to casino patrons.
- 16.2 Analysis of the food and beverages (F&B) expenses incurred for the calendar year 2006 showed that, out of ₱145,319,662 total expenses incurred, ₱32,061,021 or 22.06% was paid to the supplier of buffet meals and snacks for casino patrons. Casino Filipino Hyatt Manila (CF Hyatt) could have saved from ₱3,206,102 to ₱6,412,204, more or less, in food and beverages expenses for the year 2006 had a discount of from 10% to 20% been negotiated with the supplier of the daily buffet meals and snacks for regular customers in the gaming area.
- 16.3 We have recommended that CF-Hyatt management make representations with the owner/operator of the food chain for the granting of discounts ranging from 10% to 20% similar to other concessionaires servicing the different PAGCOR casinos nationwide.
- 16.4 It was informed that a meeting was made with the officers of the food chain to negotiate for the granting of the 10% to 20% discount. In that meeting the

officers of the F&B supplier gave their word that the request will be conveyed to the owner for disposition.

**17. Cash shortage per Branch Capital Accountability Report unrecorded in the books of CF-Cebu**

- 17.1 Treasury Cash Capital is a fixed amount issued by Corporate Treasury Department (CTD) to finance branch gaming operations. It is maintained in an Imprest Fund system, and for purposes of determining accountability, an accountable officer prepares a Branch Capital Report (BCR) to show the movement of cash capital from one accountable person to another at the beginning and end of every shift. At month end, the CTD conducts an inventory of cash capital and summarizes the results of this activity in the Branch Capital Accountability Report (BRACAP). The BRACAP shows the breakdown of cash capital into cash in the vaults, Slot Machine stacker, Slot Machine arcade, with tellers and others; cash in savings, current and time deposits; and other cash items. The determination and disclosure of any shortage in the accountability of the tellers and the Vault in Charge is made at these stages of treasury operation preparatory to settlement.
- 17.2 Under existing policies, the settlement of any shortage is covered by the personal contributions of the accountable officers (AOs) concerned to the Tellers Overage/Shortage Account (TOSA) fund. If the AO's contribution is insufficient to cover the shortage, he/she may choose to make a direct personal payment to the CTD. Another mode of settlement may be through payroll deduction, subject to the approval of the Branch Management Panel committee. In addition, pursuant to standards under the COA Cash Examination Manual, shortages incurred by officers in their accounts are receivables, which should be disclosed in the books to ensure transparency in the collection and settlement of the accounts.
- 17.3 In the periodic review of the BRACAPS, it was noted that shortages amounting to ₱179,766 incurred by the CTD from January to December 2006, were reported as part of the Cash Capital balance being settled thru payroll deduction.
- 17.4 It was observed that the method for disclosure and settlement of shortages in AOs accounts, as described above, are practically sufficient in form, except that the accountability for shortages are not recorded in the books of accounts as required under COA rules and regulations on proper handling of cash accountability.
- 17.5 We had recommended and Management agreed that whenever the TOSA is not sufficient to cover these shortages, or if settlement by direct payment to the CTD is not feasible, such shortages may be replenished immediately from the Treasury Department OPEX Fund. It was also suggested that the Accounting Section recognize a Receivable-Due from Officers and Employees account in the books to ensure transparency in the subsequent collection and settlement of accounts.

**18. Accounting for the 1.2% commission under the Non-Negotiable Chips Program**

18.1 The non-negotiable chips (NNC) or “dead” chips program is a marketing incentive that many casinos worldwide put in place to entice and retain foreign and local high-rollers. It is a form of chip washing in which a player must use purchased NNC solely for wagering at the gaming table. The player is entitled to a 1.2% commission or discount every time he/she exchanges cashable or live chips for dead chips, which is also termed as rolling commission, on the condition that he has to wager all the NNC he purchased. After the player finishes playing, the 1.2% commission shall be computed based on the net total buy-in of NNC less returned, as recorded in his/her player’s rolling account card (PRAC). The player is paid in the form of cashable chips for the one percent (1%) and cash coupons for the 0.2%. The cash coupons can be used exclusively at the Casino Filipino (CF)-Hyatt, valid for 30 days but may be extended upon the approval of the Senior Branch Manager (SBM). The cash equivalent of the 0.2% is paid by the branch directly to the CF-Hyatt lessor every month.

18.2 Under the pre-approved guidelines documented by the Treasury Division, these commissions are treated as a negative adjustment on the day’s table win/loss report. The amount of the 1.2% commission is computed based on the tables/vault to vault exchanges of NNC to cashable chips for the day as evidenced by the “exchange slips” and summarized in a report for approval by the SBM. The said report serves as the supporting document for the negative adjustment on winnings. Such procedure is not in accordance with the guidelines, that commission shall be computed based on net-total buy-in of NNC less returned after the player had finished playing per the PRAC maintained by Treasury Division.

18.3 The negative adjustment to income (table’s win/loss) is not equal to the actual commissions paid to players as evidenced by the document “Payment of the 1.2% Commission” where such payments are acknowledged by players. There are players who play and lose in a particular month/day but do not claim commissions during that month/day. Records show that for the three months of October, November and December 2006, there were discrepancies between the actual commissions paid to players per report on payment of the 1.2% commission and the reported negative adjustment to winnings per the win/loss report, presented hereunder:

<b>Month</b>	<b>Total Actual Commission Paid</b>	<b>Negative Adjustment per Win/Loss Report</b>	<b>Difference</b>
December	₱37,973,376.00	₱36,961,152.00	(₱1,012,224.00)
November	38,641,492.00	39,291,880.00	640,388.00
October	46,795,860.00	46,504,248.00	(291,612.00)

- 18.4 The NNC program is similar to the Rebates Program wherein players are given rebates based on losses. The rebates are taken up as a deduction from the shift's income once payment is made to the player. In the NNC special program, the commission is called "rolling commission" because it is based on net rolling capital.
- 18.5 Under the New Government Accounting System (NGAS), the accrual method of accounting has been adopted. However, because of the unique nature of the business of PAGCOR, all winnings are recorded in the books using the cash method.
- 18.6 We have recommended that all recorded transactions must represent economic events that actually occurred, hence the negative adjustments to income must be recognized when incurred or reflected in the table's win/loss report only when actually paid out during a given period following the method in the recording for revenues (winnings) which is cash basis.

**19. Absence of appropriate supervisory control over the work of persons involve in the NNC operation**

- 19.1 Supervisory control simply deals with the review and/or approval of transactions by designated officers.
- 19.2 Review of relevant documents revealed that the report, "Payment of the 1.2% Commission" does not bear the approval of the officer before payment is made to concerned players. At the end of the player's playing period, the NNC Teller adds all purchased NNC recorded in the player's rolling account card (PRAC) net of returns. He then encodes in the computer system the net rolling capital, the equivalent amount of 1% cash bonus (commission) and the 0.2% cash coupon including the series number of the coupons to be issued. A printout of the encoded data is generated, attached to the PRAC and submitted to the Vault in Charge (VIC) for payment. The VIC then computes for the 1% cash bonus and the 0.2% cash coupon based on the player's net rolling capital, affixes his/her signature and finally releases the commission due to the player. The subject document, however, is not submitted to the branch senior officer for approval before it is released and/or paid to a particular player.
- 19.3 It was noted that there were transactions where the commissions granted/ given ranged from ₱500,000 to as much as ₱2.4 million as shown in our test month. The nature of the transaction is similar to a disbursement of funds, only that this is recorded as a negative adjustment to income (winnings). Under existing policies and procedures, all transactions require the approval of proper officials before they are consummated and recorded in the books of accounts. Such approval of transactions is subject to the authority limits as defined in the Manual of Signing Authority. Hence, the action of the VIC to pay without securing the approval of proper officials is not in accordance with the rules and regulations of the agency.

19.4 We have recommended that the VIC obtain the approval of proper officers before payment of the commission is made to particular players. The levels of signing authority must be clearly defined so that officials will act within the scope of the authority granted to them.

## **20. No proper segregation of duties in the NNC program operations**

- 20.1 Segregation of key duties and responsibilities between authorizing, processing and reviewing transactions and payment transactions is a control measure used to ensure that concealment of errors by persons who are in a position to perpetuate them is eliminated.
- 20.2 In the non negotiable chips (NNC) program, it was noted that the determination of the net rolling capital was done by the teller while the computation and payment of the 1.2% commission was performed by the VIC. This was not reviewed/checked by someone other than the teller and the VIC resulting in miscalculation, erroneous extension of amounts, etc. Miscalculations could have been avoided if someone performs the necessary review and/or checking of transaction documents.
- 20.3 We have recommended to the branch management that policies and procedures be put in place to reduce the risk of error, waste or wrongful acts that might occur, if one individual or section controls all key stages of a transaction. It was also suggested that duties and responsibilities be assigned systematically to different individuals to ensure that effective check and balance exist.
- 20.4 Management commented that a committee was formed to study the present practices in the branch's NNC operations and to come up with recommendations to improve the system and strengthen internal controls in the handling and documentation of NNC transactions, taking into consideration COA's recommendations on the subject.
- 20.5 Management stated further that, after a careful evaluation of the various aspects of the operation, recommendations to ensure the proper monitoring and recording of transactions, accurate payments, proper charging of accounts and strengthening of internal controls are now being finalized, giving due consideration to COA's recommendations. A memorandum recommending the adoption of new/additional guidelines to govern the program shall then be sent to the Board for approval.
- 20.6 As to the accounting aspect of the NNC operation, hereunder are the comments submitted by the Senior Treasury Head:
- a. Exchange receipts are handled by the Vault in Charge (VIC) and checked/ noted by the Treasury Officer on duty, yet discrepancies on entries were not corrected, hence treasury personnel concerned were

admonished that repetition of the same negligence shall be dealt with corresponding sanctions.

- b. Vault In-charge post on the extension the actual amount of exchanges since the quantities are covered by formula. In most cases, the formula is overwritten, making the number of pieces erroneous. Even the Treasury Officer responsible for checking the correctness and completeness of every exchange transaction receipt overlooks the error. In this regard, the Treasury Officers and Vault In-Charge concerned were told that negligence to spot/check errors shall be meted with corresponding sanctions.
- c. Income adjustment representing 1.2% commission under the present practice is based on the actual table to treasury exchanges, which means the actual NNC's played on the gaming table for the day. A recommendation will be submitted to the Board of Directors for approval that the 1.2% commission adjustment be based on the actual commission paid for the day.
- d. On internal control improvements, we will submit to the Board of Directors a recommendation to the effect that the release of the 1.2% commission shall be subject to the approval of the Senior Branch Manager, in his absence, the Branch Manager, in his absence, the Casino Shift Manager, in his absence the Assistant Branch Manager on-duty.

## **21. Other PPE-Fixed Assets Clearing account balance not reclassified to proper account in CF Tagaytay**

21.1 The Fixed assets module under the Enterprise Resource Planning (ERP) System includes suspense accounts such as: Other Property Plant and Equipment (PPE) – Fixed Assets Clearing and Gain/Loss on Sale of assets. By their very nature, being suspense accounts, it is required that at month-end these accounts have zero balances.

21.2 At CF Tagaytay branch, the account Other PPE-Fixed Assets Clearing consists of newly purchased items, including transferred property items from Head Office subject to proper asset classification. At month-end, items debited to this account with incomplete documentation are credited for the remaining amount in order to maintain the zero balance of the account in the ERP system. Whatever amount is credited during the preceding month is restored to the original debit amount on the following month.

21.3 Analysis of the Other PPE-Fixed Asset Clearing account showed an increase to P1,785,491 in 2006, from P1,486,589 in 2005. Further review revealed 46 property items with costs ranging from P1,200 to P225,631 recorded from April to December 2006 requiring the completion of the required documentation, summarized as follows:

Period Acquired	No. of Items	Amount
April 2006	1	P 1,200
May 2006	4	229,365
June 2006	2	10,500
July 2006	3	318,886
August 2006	5	315,185
September 2006	5	36,303
October 2006	6	70,605
November 2006	5	376,311
December 2006	15	427,136
	----	
	<u>46</u>	<u>P 1,785,491</u>

21.4 Because the above items were not reclassified to proper PPE accounts, the related depreciation expense was not recorded, resulting in the overstatement of asset accounts and understatement of expenses.

21.5 The amount involved may be immaterial for the current year, but if undocumented property items increase in subsequent years, Management may have to spend more time in the verification and reconciliation of said items.

21.6 We have recommended that the CF Tagaytay management complete the documentation of these property items so that these can be reclassified to the proper PPE accounts and appropriate depreciation expense may be recorded.

**22. Cost/Residual value of PPE received from other branches/corporate office not recorded in the books of CF-Hyatt**

22.1 Starting year 2005, PAGCOR made a shift from the cash basis of accounting to accrual basis of accounting and adopted NGAS. Under the new system, items previously classified as semi-expendable (SE), irrespective of amount, are classified as property, plant and equipment (PPE) except those covered by COA Circular No. 2005-002 dated April 14, 2005. In a memorandum issued by the Accounting Department, PAGCOR Corporate Office, all PPE acquired prior to January 1, 2005 shall be set-up in the books of accounts at its residual value while those acquired after January 1, 2005 will be recorded in the books at acquisition cost.

22.2 Per information gathered, PPE items with SE numbers were received by CF-Hyatt from other casino branches/corporate office in 2006 and 2005, hence included in the physical inventory report for the year 2006. Under the old system, if cost is less than P10,000, an item is classified as semi-expendable, hence it was assigned an SE number. Although these items were taken up in the records of Property and Procurement Division (PPD), CF Hyatt, there was no record at the Accounting Division because debit memos transferring the PPE cost/residual value were not yet received from the Corporate Office.

Per standard operating procedures, debit and/or credit memos covering transfer of properties from one branch to another or from corporate office to branch, should emanate from the Corporate Office.

- 22.3 In view of the above, the Property, Plant and Equipment account was understated by ₱112,489 as of December 31, 2006 due to the non-recognition in the books of the cost/residual value of various PPE items received from other CF branches and Corporate Office.
- 22.4 We have recommended the coordination of either or both the branch's PPD and Accounting Division with the department in the Corporate Office to effect the speedy transfer of all cost and valuation accounts of PPE items received to reconcile the records of the two branch divisions mentioned above.
- 22.5 Management commented that the Accounting Division is still waiting for the debit memos from the PAGCOR-Corporate Office to avoid double take-up of fixed assets transferred by other branches/corporate office.

**23. Unserviceable equipment not reclassified to Other Assets- Fixed Assets for Disposition account in two CF branches**

- 23.1 The new government accounting system (NGAS) requires that equipment no longer used in operation or waiting for disposal due to unserviceability or obsolescence, shall be reclassified to Other Assets-Fixed Assets for Disposition account.
- 23.2 Review of the report of physical inventory of property and equipment revealed that the report includes unserviceable equipment amounting to ₱ 2.246 million. Examination of the related general ledger accounts showed that said equipment were still classified under the account Property, Plant and Equipment in the books of CF Davao for ₱1.940 million and CF Bacolod for ₱.306 million.
- 23.3 In reply to last year's audit observation about this matter, Management committed that a report on unserviceable equipment is to be prepared for another possible disposal. As of audit date, Management has not acted on this commitment. The Accounting personnel could not just effect reclassification of the above equipment without the report of the Property Division. Further, there could be difficulty in locating and identifying the assigned property number of equipment during inspection as others might have been misplaced in view of the storage problem and big volume of those subject for disposal.
- 23.4 The proper and correct presentation of assets in the financial statements is very important for Management's information and guidance in its decision-making. Likewise, not reclassifying the unserviceable equipment to account Other Assets- Fixed Assets for Disposal was not in accordance with the NGAS and could misinform Management of the current condition of its property and equipment.

23.5 We have recommended that Management require immediately the concerned Property personnel to prepare a report on all unserviceable equipment as basis of the Accounting Personnel in reclassifying them to account Other Assets-Fixed Assets for Disposition for proper presentation of the accounts in the financial statements. Henceforth, it is suggested that this report be prepared regularly for proper recording in the books and as basis for disposal. The report is to include the recommended mode of disposal for evaluation and approval by Management.

#### **24. Stock ledger cards for supplies and materials not maintained at CF Bacolod**

24.1 The Branch has four responsibility centers for inventory. These are the (a) Property section for supplies and materials acquired and held for stocking purposes, (b) Bingo department, for bingo cards, and (c) Hotel/F&B, for food and beverages. The inventories are normally carried for financial reporting at the moving average cost, pursuant to NGAS.

24.2 However, we noted that the inventory recording system, which is covered by a separate computer software, has not been integrated into the ERP. We also observed that contrary to the principle of NGAS, the branch has not totally adopted the use of stock ledger cards, as focal point in the reconciliation of actual inventory balances reflected in the stock cards maintained by the property unit, as against the quantity and cost of inventory as reflected in the accounting records.

24.3 Non-compliance with inventory policies, particularly on the use of moving average method of inventory valuation, may result in misstatement of the account.

24.4 We have recommended that CF Bacolod management require the accounting unit to maintain stock ledger cards and to use the moving average for inventory valuation, pursuant to NGAS.