METROPOLITAN WATERWORKS AND SEWERAGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
(In Thousand Pesos)

1. CORPORATE INFORMATION

The Metropolitan Waterworks and Sewerage System (MWSS) is a government-owned and controlled corporation was created under Republic Act No. 6234 dated June 19, 1971 to replace the National Waterworks and Sewerage Authority (NAWASA). The System is an attached agency to the Department of Public Works and Highways. Its main objective is to ensure an uninterrupted and adequate supply and distribution of potable water for domestic and other purposes to its consumers at just and equitable rates. It also aims to provide sewerage and sanitation services to the public. MWSS owns and has jurisdiction over all waterworks and sewerage system of all the cities and municipalities in Metro Manila, the Province of Rizal, some municipalities of Cavite and on bulk water supply basis, the Province of Bulacan.

Because of the need for the government to adopt urgent and effective measures and to address the nationwide water crisis which adversely affected the health and well-being of the public, Republic Act No. 8041, also known as the National Water Crisis Act of 1995, was enacted and implemented under Executive Order No. 286 dated December 6, 1995, to reorganize the MWSS. The issuance of Executive Order No. 311 on March 20, 1996 encouraged private sector participation in the operation of the facilities of MWSS via concession agreements.

After conducting a competitive public bidding and selection process, the MWSS entered on February 21, 1997 into separate Concession Agreements (CA) with two private companies (Concessionaires), namely, the Manila Water Company Incorporated (MWCI) and the Maynilad Water Services Incorporated (MWSI), granting them the rights to manage, operate, repair, decommission and refurbish the Facilities in the Service Area, including the right to bill and collect for water and sewerage services supplied in the Service Area. MWCI is responsible for East Zone while MWSI services the West Zone. The concessionaires formally took over the operations from MWSS on August 1, 1997. In addition to the performance of the service obligations, the concessionaires are required, under the CA, to pay MWSS concession fees in consideration for such right.

Pursuant to the Concession Agreements, the MWSS created the MWSS Regulatory Office (RO) as a unit operationally independent of MWSS-Corporate Office (CO).

On March 8, 2001, due to financial difficulties, MWSI suspended payment of concession fees. From March 2001 to July 2001, MWSS used its own funds to meet the maturing obligations of or assigned to MWSI. From July 2001 to 2006, MWSS had to obtain a number of loans from various banks and financial institutions to meet the maturing obligations and expenses that the (unpaid) concession fees from MWSI were supposed to cover.

The disputes between MWSI and MWSS ripened into a "Notice of Early Termination of the Concession" on December 9, 2002 and arbitration began on January 7, 2003. On November 7, 2003, the Appeals/Arbitral Panel for Major Disputes ruled that (1) there was no MWSS or Concessionaire Event of Termination under Article 10 of the CA, (2) the parties should continue to perform their obligations under the CA until the expiration thereof, and (3) MWSS may draw on the USD120 Million Performance Bond. The Arbitration Order became final on November 22, 2003.

During the pendency of the corporate rehabilitation proceedings for MWSI, and prior to the drawing on its USD120 million Performance Bond, MWSS continued to resort to various loans to meet its maturing obligations and operating expenses. On March 16, 2004, the MWSS supported by a sovereign guarantee, issued Notes which were fully subscribed by BNP Paribas, the MWSS-BNP Notes.

On April 29, 2005, MWSI submitted to the Rehabilitation Court its 2005 Rehabilitation Plan incorporating the terms and conditions of the Debt and Capital Restructuring Agreement (DCRA) executed among MWSI, MWSS, Benpres Holdings Corporation, the Suez Group and other lenders. On June 1, 2005, the Rehabilitation Court approved the 2005 Rehabilitation Plan, including the DCRA.

Under Clause 2.6 of the DCRA, MWSS was given the right to subscribe to 83.97% of the shares of MWSI. On September 8, 2005, the MWSS Board of Trustees resolved to assign the MWSS Subscription Rights pursuant to Clause 24 of the DCRA. After going through a competitive public bidding and selection process, DMCI-MPIC Water Company, Inc. (DMCI) was awarded the MWSS Subscription Rights and the right to acquire receivables of MWSS, subject to the conditions imposed under the DCRA. On December 27, 2006, MWSS and DWCI entered into an Assignment and Assumption Agreement (AAA) to formalize the award.

In accordance with the AAA, DMCI, decided to effect the early exit of MWSI from rehabilitation proceeding by contributing cash to the latter and enabling the latter to prepay, among others, its obligations to MWSS under the DCRA. To implement this, DMCI entered into a Prepayment and Settlement Agreement (PSA) with MWSI, MWSS, the Suez Group and other lenders on August 9, 2007.

Thereafter, MWSI MWSS, the Suez Group, and other creditors of MWSI filed a Joint Omnibus Motion dated August 14, 2007 as a result of the Rehabilitation Court issued order dated December 19, 2007 (1) immediately approving the PSA, (2) declaring that Maynilad had successfully implemented the 2005 Rehabilitation Plan subject to the fulfillment of certain conditions, and (3) disallowing the disputed or unresolved claims of MWSS and the Suez Group. On February 6, 2008, the Rehabilitation Court issued another order confirming the December 19, 2007 Order, declaring that the conditions in its previous order have been met, and releasing MWSI from the corporate rehabilitation proceedings.

During the 11th year of the implementation of the CA, the Parties, MWSS and MWCI and MWSI (under a new Sponsor, DMCI) identified and discussed the option of renewing/extending the Concession Agreement pursuant to the following government policies:

a. To increase investments in water and wastewater improvement projects, to pursue the mandate of the government to accelerate waste water projects, to comply with the Clean Water Act and the recent Supreme Court decision for the clean up and preservation of Manila Bay, and sufficient concession fees to support the implementation of new water source projects as enumerated in the Final Business Plan;

b. To mitigate the impact on tariff increases through the renewal/extension of the Concession Agreement.

On October 19, 2009, the Department of Finance (DOF) transmitted to the MWSS, the signed letter of Consent and Undertaking in behalf of the Republic the approval of extension of the CA of MWCI to an additional of 15 years from May 7, 2022 to May 6, 2037

On March 17, 2010, the DOF thru the MWSS, again transmitted the signed Letter of Undertaking in behalf of the Republic another approval of 15 years extension of the CA of the MWSI from May 6, 2022 to May 6, 2037.

The Term Extension committed the Concessionaires to increase by 100% the concession fees (Corporate Operating Budget or COB) of the MWSS - CO and RO.

In CY 2013, the third Rate Rebasing (RR) was performed to review the performance of the Concessionaires as well as to evaluate the new business plans of the MWCI and MWSI. The exercise set the rates for water and sewerage services provided by the Concessionaires at a level that will permit them to recover over the term of the Concession (net of any grants from third parties and any Expiration Payment) operating, capital maintenance and investment expenditures efficiently and prudently incurred, Philippine business taxes and payments corresponding to debt service on the MWSS Loans and Concessionaires Loans incurred to finance such expenditures, and to earn a rate of return (referred to as “Appropriate Discount Rate” on these expenditures for the remaining term of the Concession in line with the rates of return being allowed from time to time operators of long term infrastructure concession arrangements in other countries having a credit standing similar to that of the Philippines.

As a result of the RR exercise, the RO recommended, and, on 12 September 2013, the MWSS Board of Trustees resolved:

- :To deny MWCI’s petition for an upward adjustment of 22.79% of its average basic water charge or P5.83 per cubic meter beginning January 1, 2013; and
- To approve and effect a negative adjustment of 29.47% of its 2012 average basic water charge of P24.57 per cubic meter to be implemented in five equal tranches of negative 5.894% per Charging Year.

MWCI objected to MWSS RR determination and commenced arbitration under the 1976 United National Commission on International Trade Law (UNCITRAL) Arbitration Rules, in the case entitled Manila Water Company, Inc. vs MWSS and the Regulatory Office which was subsequently docketed with the International Chamber of Commerce (ICC) as Case No. UNC 136/CYK.

On February 27, 2015, the RO received a copy of the Partial Award in ICC Case No. UNC136/CYK. The dispositive portion reads:

a.) Corporate Income Tax (CIT) is not an allowed Expenditures under the CA;

b.) The Appropriate Discount Rate should not be computed fully pre-tax; and

c.) Each Party is to bear its own legal and other costs. The cost of the arbitration including the fees and expenses of the Appeals Panel are to be borne equally by MWSS and MWCI.

On April 21, 2015, the RO received a copy of the Final Award in ICC Case No. UNC136/CYK. The dispositive portion reads:

a) Affirm that the parties have reached agreement on the Rate Rebasing Adjustment after taking to account the Partial Award dated 26 February 2015;

b) Order that the Rate Rebasing Adjustment for the period 2013 to 2017 be set as a negative adjustment of 11.05% of MWCI’s 2012 average basic charge of P25.07 per cu.m. or negative P2.77 per cu.m. to be implemented in 5 equal tranches of negative 2.21% per charging year, pursuant to Article 9.4.3 (ii) of the CA; and

c) Order that each party is to bear its own legal and other costs.

On April 30, 2015, the RO transmitted its Resolution No. 2015-0905-CA to the MWSS Board of Trustees containing the MWCI's determination of 2015 RAL as follows:

a) To set the 2015 RAL of Manila Water at negative 2.42% to be applied on the prevailing basic charge; and

b) To recommend the publication of the 2015 Table of Standard Rates for Manila Water pursuant to the requirement under Section 12 of the MWSS Charter that such "rates and fees shall be effective and enforceable fifteen (15) days after publication in a newspaper of general circulation.

Board Resolution No. 2015-058-RO dated May 8, 2015 resolved, approved and confirmed the above recommendation. The Rate Adjustment of MWCI took effect June 1, 2015.

As for MWSI, on March 30, 2012, the Concessionaire filed a petition for the determination of its "R: factor for the third RR, proposing an upward adjustment of 24.69% of its average basic water charge or P7.41 per cubic meter beginning January 1, 2013.

On September 14, 2012, MWSI revised their proposed rate adjustment to 34.06% of its average basic charge – or an equivalent increase of P10.31 per cubic meter

Pending the final determination of the "R", MWSI in a letter dated November 26, 2012, sought an interim rate increase of at least 20% of P2.06 per cubic meter of the anticipated "R" based on its September 2012 Business Plan. The MWSS Board of Trustees, upon the recommendation of the RO in Resolution No. 2012-010-CA dated December 3, 2012, declined MWSI proposed interim rate increase, but allowed the "C" factor of 3.2%.

On September 12, 2013, the MWSS Board of Trustees resolved and adopted the recommendation of the RO:

- To deny MWSI's petition for an upward adjustment of its 2012 average basic water charge;
- To approve and effect a negative adjustment of 4.82% of its 2012 average basic water charge of P30.28 per cu.m. to be implemented in five equal tranches of negative 0.964% per Charging year; and
- To discontinue of the implementation of the Currency Exchange Rate Adjustment (CERA).

MWSI objected to MWSS RR determination and commenced arbitration under the 1976 UNCITRAL Arbitration Rules, in the case entitled MWSI vs MWSS and Regulatory Office which was subsequently docketed with the ICC as Case No. UNC 141/CYK.

MWSI argued that the RO erred in the RR Determination and enumerated the following grounds for its objection to and disagreement with the same:

1. Unauthorized disallowance of corporate income tax;
2. Incorrect estimate of the ADR for Future Cash Flows;
3. Unauthorized adjustments to the Opening Cash Position set during the last Rate Rebasing;

4. Improper addition of Guaranty Deposits to MWSI's historical and future receipts;
5. unreasonable and improper disallowances in other expenditures in the Opening Cash Position; and
6. Unreasonable and improper adjustment to other expenditures in the Future Cash Flows.

On December 29, 2014, the Appeals Panel in the MWSI dispute promulgated its Final Award as follows:

1. By majority, finds that the MWSI is entitled to include its Corporate Income Tax (CIT) in its Future Cash Flows for each year of operation;
2. By majority, upholds Claimant's alternative Rebasing Adjustment for the 4th Rate Rebasing Period of 13.41%, which means an average basic water charge of P30.28 per cu.m. resulting in an adjusted rate of P34.34 per cu.m for every charging year of the 4th Rate Rebasing Period;
3. Unanimously decides that each Party shall bear its own legal costs and that the costs of the arbitration shall be borne by the Parties equally;
4. Unanimously orders Respondents to reimburse to Claimant the sums of USD15,012.50, Php540,502.81 and HKD179.73, representing Respondents' share of the costs of the arbitration that were advanced by the Claimant' and
5. Dismiss all other claims.

Finding the conclusion reached by the Appeals Panel in the MWSI Dispute as directly in contrast to the conclusions reached in the MWCI Dispute, the MWSS Board of Trustees, in its Resolution No. 2015-039 RO dated 31 March 2015, approved the recommendation of the RO for the partial implementation of the Arbitral Award with respect to the other items not related to corporate income tax.

In its letter dated 24 April 2015, MWSI maintained that it is not amenable to the partial implementation of the Final Award and stated that:

1. It will not implement the partial "R: as directed
2. It will implement the annual "C: factor which has never been in dispute; and
3. It will continue to collect the CERA.

MWSI proposed to limit any adjustment on the 2013 average basic charge to the "C" factors for Charging Years 2014 and 2015.

Upon careful review and thorough deliberations, the RO resolved to grant the request of MWSI, for the following reasons:

1. Consistent with the RO Resolution No. 2012-010-CA dated December 3, 2012 and MWSS Board Resolution No. 2012-165 dated December 7, 2012, MWSI shall receive the "C" factor of the RAL pending the final resolution of the "R";
2. Consistent with RO Resolution No. 13-008-CA dated September 6, 2013 and MWSS Board Resolution No. 2013-100-RO dated 2013-100-RO dated September 12, 2013, MWSI shall no longer collect CERA;
3. Consistent with RO Resolution No. 2015-004-CA dated March 25, 2015 and MWSS Board Resolution No. 2015-039-RO dated March 31, 2015, MWSI

will not charge the CIT component of its alternative “R: pending a more definite ruling by a court of justice on the CIT issue; and

4. Consistent with RO Resolution No. 2014-002-CA dated December 17,2014 and MWSS Board Resolution No. 2013-129-RO dated December 12, 2014, which restored the FCDA adjustments, the proposal will bring regularity to the rate adjustment mechanism under the CA.

On May 14, 2015, MWSS Board Resolution No. 2015-060-RO resolved, approved and confirmed the resolutions of the RO as follows:

a.) To set the 2015 RAL for MWSI at 7.52% to be applied on the prevailing basic charge;

b.) To implement the discontinuance of the charging the CERA; and

c.) To recommend the publication of the 2015 Table of Standard Rates for MWSI pursuant to the requirement under Section 12 of the MWSS Charter that such “rates and fees shall be effective and enforceable fifteen (15) days after publication in a newspaper of general circulation.”

The Rate Adjustment of MWSI took effect June 1, 2015.

The recoverability of the CIT is an urgent and real issue for the Supreme Court to resolve. On April 24, 2015, the MWSS through its statutory counsel, Office fo the Government Corporate Counsel, filed a Manifestation in the SC to note in the Court’s deliberations the conflicting Final Awards in the arbitrations with the Concessioniares.

SOURCES OF FUNDS

The following are the sources of funds of MWSS:

- Concession fees collected
- Rentals on leased properties
- Interest income on investments
- Loan availments from foreign and domestic financial institutions
- Collection of raw water charges and accounts receivable
- Other incidental revenues

STRATEGIC INITIATIVES AND WATER SECURITY LEGACY BUBBLE

Water Security Legacy (WSL) Roadmap – MWSS is driven by the Water Security Legacy Roadmap and is composed of seven legacies to help ensure a more holistic, long-term and sustainable approach to water service for Metro Manila and its outskirts. These legacies are:

a) Legacy 1 – Water Resources and Infrastructure Management, Development and Protection

b) Legacy 2 – Water Distribution Efficiency

c) Legacy 3 – Sewerage and Sanitation Compliance

d) Legacy 4 – Water Rates Reviews and Rationalization

e) Legacy 5 – Organization Excellence

f) Legacy 6 – Partnership Development

g) Legacy 7 – Communication and Knowledge Management

Strategic Initiatives – MWSS – CO hereby commits to undertaking the following key programs and/or projects identified as having a significant impact on its Performance Scorecard:

a) Strategic Initiative 1 – New Centennial Water Supply Source Project (NCWSP) - Kaliwa Dam Project (P18.72 billion)

- Fund Source : Private Proponent under PPP scheme
- involves the financing, design and construction of a raw water supply source with a capacity of 600 MLD, through the commissioning of the Kaliwa Dam, including intake facilities and other pertinent facilities
- part of the Project is a water conveyance tunnel intended to supply 2,400 MLD of raw water for Metro Manila, thereby reducing heavy dependence on the Angat Dam reservoir.
- Status: Prequalification process was declared a failure last May 28, 2015 since the three (3) Bidders who submitted their PQ documents did not meet the pre-qualification requirements. On-going revision of the Pre-qualification documents and republication for prequalification is scheduled by July 4-18, 2015. As per latest timeline, the target date of contract award is in February 2016.

b) Strategic Initiative 2 – Bulacan Bulk Water Supply Project (BBWSP) (P24.22 billion)

- Funding Source : Private Proponent under PPP scheme
- Aims to provide clean and affordable treated water, will be implemented in three stages, covering 24 water service providers (WSPs) serving 21 municipalities and three cities in Bulacan.
- Will involve the development of surface water source facilities and new groundwater sources; provision of water treatment facilities and lift and booster pump stations; and the installation of new conveyance/transmission lines, among others.
- Status: There are five declared prequalified bidders and their scheduled bid submission is on July 27, 2015. Notice of Award will be in November 2015.

c) Strategic Initiative 3 – Angat Water Transmission Improvement Project (AWTIP) (P5.78 billion)

- Funding Source: Loan and GOP counterpart funded by Concession Fees
- Aims to improve the reliability and security of the Angat raw water transmission system through the rehabilitation of existing conveyance and appurtenances from Ipo Dam to the La Mesa Treatment Plant.
- Involves the construction of an additional tunnel, which will allow the alternate closing of older tunnels and aqueducts in the conveyance system. This will enable the conduct of necessary inspection and rehabilitation of portions of the systems without interrupting the transmission of water.
- Status: The First Stage Bid was held last June 5, 2015 and MWSS received eight bids. The Second State Bid is scheduled on August 28,2015. Notice of Award will be in October 2015.

d) Strategic Initiative 4 – Sumag Diversion Project

- Funding Source: Concessionaire' Fund through the Common Purpose Facility (CPF)
- Diverts additional raw water (188 MLD) from Sumag River in Gen Nakar, Quezon which will be diverted to Umiray Tunnel to augment water supply in Angat Dam.

- The proposed project involves the construction of appurtenances structures of Tyrolean Type Weir, Intake, Desilting Basis with Sluice Way, Transition Channel, Cut and Cover, Tunnel (600 linear meters with 2.70 meters diameter), Open Channel and Intrasite Access connecting to the UATP.

- Status: Heavy Lift Operation was completed on May 27, 2015; 100% of the equipment mobilization completed and 70% of the material requirement (cement, explosives and other light materials); On-going preparatory works at the site (Clearing and grubbing, temporary facilities, initial blasting works at portal); tunnel Drill and Blast operation to start at end of June 2015; Expected completion date by the Concessionaire, is in July 2016.

e) *Angat Dam and Dykes Strengthening Project (ADDSP)*

- National Government released P553 million on April 2015

- Involves the strengthening of the Angat Dam and Dyke located in Norsagaray, Bulacan, in order to ensure the safety of the structures should the West Valley Fault move and to secure these structures being the present source of 97% of Metro Manila's domestic water supply, irrigation supply for about 25,000 hectares of ricelands in Bulacan and parts of Pampanga, and power supply of 246 megawatts to the Luzon Grid and to avoid flooding downstream.

- It will include the installation of flow forecasting and warning systems beneficial to downstream towns and cities.

- Status: Ceremonial Groundbreaking for the start of construction by Angat Hydropower Corporation (AHC) is scheduled within the period July 2015; Mobilization is expected to start in August 2015 and the Project is to be completed in August 2017 (two years).

f) *Rehabilitation, Operation and Maintenance of Auxiliary turbines 4 and 5 (AN 4 & 5) of the Angat Hydro-Electric Power Plant*

- Funding Source: Private Proponent under PPP Scheme

- The proposed project involves the rehabilitation and modernization (R & M) of AN4 and AN5 that intends to increase the plant load factor (PLF) from the annual average of 21 percent and 19 percent, respectively, to 60 percent each. MWSS will enter into a rehabilitation, operation and maintenance contract with the private sector for this project.

g) Acquisition of 7.5 cms from NIA

- MWSS has requested the permanent transfer of MWSS' usage of NIA's unutilized 15 CMS. As an initial step, <u>a MOA between MWSS and NIA was signed on 11 May 2015 and another MOA between MWSS and its two concessionaires will be signed June 2015 for full and final settlement for NIA's claim for compensation (Php 1 Billion) for the initial 7.5 CMS out of the 15 CMS earlier granted to MWSS. The Php 1 Billion settlement will be used by NIA to improve the stability of the Bustos Dam ensuring continuous supply of irrigation water to the Province of Bulacan and portions of Pampanga.</u>

- In addition, the MWSS agreed to pay NIA the amount of P52 million Financial Assistance as and by way of final settlement of NIA's claim for compensation for NIA's Opportunity Losses incurred due to the reallocation of 15 CMS of water during El Nino periods of 2000-2010.

- Status: MOA between MWSS and NIA was signed on May 11, 2015; Joint Petition letter of MWSS and NIA to NWRB requesting the latter to effect the corresponding amendments to NIA and MWSS' water permits forwarded to NWRB on May 12, 2015; Coordinating with the concessionaires for the payment of P1 Billion to NIA;

Invitation to Bid for the Bustos Dam Rehabilitation Project (main works) is expected to be published by July 2015, and the project is expected to start December 2015 and completed by May 2017.

h) Strategic Initiative 5 – MWSS Reorganization

MWSS Corporate Office has an approved Reorganization based on GCG MC 2013-17. The implementation strategy is presently being finalized.

i) Strategic Initiative 6 – Customer Satisfaction Survey

The ultimate customers of both MWSS and Concessionaires are the general public to whom it serves potable water and provides sewerage and sanitation services in its franchise area. A system for obtaining feedback from our direct customers will be put in place and implemented in 2015.

The MWSS Administrator authorized the issue of the Financial Statements on June 8, 2015.

2. BASIS OF FINANCIAL STATEMENT PREPARATION

The accompanying financial statements have been prepared in accordance with applicable Philippine Financial Reporting Standards as aligned with the International Financial Reporting Standards using the historical cost basis, except for Property, Plant and Equipment which are measured at revalued amounts. The financial statements are presented in Philippine pesos, which is the System's functional and presentation currency. All values are rounded to the nearest thousand. The financial statements of the MWSS Corporate Office and the Regulatory Office are consolidated in this report.

3. CHANGES IN ACCOUNTING POLICIES

The accounting policies adopted are consistent with those of the previous financial year.

Since 2005 the System has adopted the International Financial Reporting Standards (IFRS) . These accounting standards are as follows:

- PAS 1, *Presentation of Financial Statements*, (a) provides a framework within which an entity assesses how to present fairly the effects of transactions and other events; (b) provides the base criteria for classifying liabilities as current or non-current; (c) prohibits the presentation of income from operating activities and extraordinary items in the statement of income; and (d) specifies the disclosures about key sources of estimation, uncertainty and judgments management has made in the process of applying the company's policies.

- PAS 7, *Statement of Cash Flows,* provides information about the cash flows of an entity which is useful in providing users of financial statements with basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows.

- PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, (a) removes the concept of the fundamental error and the allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors; (b) updates the previous hierarchy of guidance to which management refers and whose applicability it considers when selecting accounting policies in the absence of standards and interpretations that specifically apply; (c) defines material omission or misstatements; and (d) describes how to apply the concept of materiality when applying accounting policies and correcting errors.

- PAS 10*.* *Events after the Balance Sheet Date,* provides a limited clarification of the accounting for dividends declared after the balance sheet date.

- PAS 16, *Property, Plant and Equipment*, (a) provides additional guidance and clarification on recognition and measurement of items of property, plant and equipment (b) requires the capitalization of the costs of asset dismantling, removal or restoration as a result of either acquiring or having used the asset for purposes other than to produce inventories during the period; and (c) requires measurement of an item of property , plant and equipment acquired in exchange for a non-monetary asset or a combination of monetary and non-monetary assets at fair value, unless the exchange transaction lacks commercial substance. Under the previous version of the standard, an entity measured such an acquired asset at fair value unless the exchanged assets were similar.

- PAS 17, *Leases,* prescribes for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to leases.

- PAS 18, Revenue, prescribes the accounting treatment of revenue arising from certain types of transaction and events. The primary issue in accounting for revenue is determining when to recognize revenue.

- PAS 19, Employee Benefits, prescribes the accounting and disclosure for employee benefits. It requires an entity to recognize: (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and (b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

- PAS 21, *The Effects of Changes in Foreign Exchange Rates* eliminates the deferral/capitalization of foreign exchange differentials. The adoption of the standard resulted in the recognition of gain or loss on foreign exchange transactions.

- PAS 23 (Revised), *Borrowing Costs,* prescribes that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asses shall form part of the cost of that asset. Other borrowing costs are recognized as an expense. The main change is the removal of the option of immediately recognizing as an expense borrowing costs that are directly attributable to the acquisition, construction or productivity of a qualifying asset. A qualifying asset is one that takes a substantial period of time to get ready for use or sale. An entity is therefore required to capitalize such borrowing costs as part of the cost of the asset. The standard does not require the capitalization of borrowing costs relating to assets measured at fair value, and inventories, even if they take a substantial period to time to get ready for use or sale. The standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after January 1, 2009.

- PAS 36, *Impairment of Asset*, establishes frequency of impairment testing for certain intangibles and provides additional guidance on the measurement of an asset's value in use.

- PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, ensures that appropriate recognition criteria and measurements bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the note to enable users to understand their nature timing and amount.

- PAS 38, *Intangible Assets* outlines the accounting requirements for intangible assets, which are non-monetary assets which are without physical substance and identifiable (either being separable or arising from contractual or other legal rights). Intangible assets meeting the relevant recognition criteria are initially measured at cost, subsequently measured at cost or using the revaluation model, and amortized on a systematic basis over their useful lives (unless the asset has an indefinite useful life, in which case it is not amortized). If recognition criteria of these intangible item does not meet both the definition of and the criteria for recognition as an intangible asset, PAS 38 requires the expenditure on these items to be recognized as an expense when it is incurred.

- PAS 40, Investment Property applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Investment properties are initially measured at cost. May be subsequently measured using a cost model or fair value model, with changes in the fair value under the fair value model being recognized in profit or loss.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash in bank earns interest at the respective authorized government depository bank rates. Cash equivalents are short term, high liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from dates of acquisition and that are subject to an insignificant risk of changes in values. Cash equivalents are for varying period of up to three months depending on the immediate cash requirements of the System, and earn interest at the respective investment rates. Due to the short term nature of the transaction, the fair value of cash and cash equivalents and short term investment approximates the amount at the time of initial recognition.

Receivables

Receivables are recognized and carried at original billed amount. Provision for doubtful accounts on water/sewer accounts receivable prior to privatization is maintained at a level considered adequate to provide for potential losses on receivables. The level of this provision or allowance is based on management's evaluation of collection experience and other factors that may affect collectability.

Property, plant and equipment

Property, plant and equipment (PPE), except those fully depreciated and those classified as administration equipment, are stated at appraised value based on the appraisal conducted in 1995 by Cuervo Appraisers Inc. In CY 2014, the appraisal increase on the Land account was based on Concessionaire's Asset Condition Report (CACR) of CY 2010 of the Regulatory Office prepared by Top Consult Incorporated.

Depreciation of PPE commences once the properties become operational and available for use, and are calculated on a straight-line basis over the estimated useful lives of the property, plant and equipment.

Minor repairs and maintenance costs are expensed when incurred, while major repairs and/or those repairs that will prolong the useful lives of the assets are capitalized.

When property and equipment are retired or disposed of, the cost and the related accumulated depreciation, amortization and accumulated provision for impairment losses, as the case may be, are removed from the accounts and any resulting gain or loss is recognized in profit or loss.

The useful lives and the depreciation and amortization methods are reviewed periodically to ensure that they are consistent with the expected pattern of consumption of the future economic benefits embodied in the items of property, plant and equipment.

An oil painting by H.R. Ocampo “Abstract in Red and Black” and the water color painting “Rooster” by Kiukok, both declared National Artists of the Philippines are listed in the PPE. These have yet to be registered in the Philippine Registry of Cultural Property of the National Museum per IRR of RA 10066 otherwise known as The Cultural Heritage Act of 2009.

Construction in-progress

Construction in-progress is stated at cost. While the construction is in progress, project costs are accrued based on the contractors’ accomplishment reports and billings. These represent costs incurred for technical services and capital works program contracted by the System to facilitate the implementation of the project. While the construction of the project is in progress, no provision for depreciation is recognized.

Construction in-progress is transferred to the related Property, Plant and Equipment account when the construction or installation and related activities necessary to prepare the property, plant and equipment for their intended use have been completed, and the property, plant and equipment are ready for service.

Long-term foreign loans

Long-term foreign loans are recorded in peso based on the exchange rate at the time of withdrawal and are revalued at the end of each reporting date.

Impairment of financial assets

An assessment is made at each reporting date to determine whether there is any indication of impairment of assets, or whether there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset’s recoverable amount is estimated. An asset’s recoverable amount is calculated as the higher of the asset’s value in use or its net selling price.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to operations in the year in which it arises.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however, not to an amount higher than the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. In 2004, an impairment loss was recognized by MWSS for the Umiray-Angat Transbasin due to damages caused by typhoons. The impairment was effected in the books only in 2005, thus, it was charged directly to Retained Earnings of that year.

Leases

A lease where the lessor retains substantially all the risk and benefits of ownership of the asset is classified as an operating lease.

Revenue recognition

All Concession fees billed/collected/received from the Concessionaires are treated as operating revenue.

Concession fees – Debt Service and Progress Billings are concession fees received from the Concessionaires that are intended for MWSS loan amortization and payments to contractors/suppliers, respectively. These are pass-on payment without any margin in favor of MWSS. Concession Fee – COB is the annual Current Operating Budget being paid by the Concessionaires to MWSS for administrative expenditures and is subject to annual Consumer Price Index adjustment.

Foreign currency-denominated transactions

Foreign currency-denominated transactions are recorded using the exchange rate on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the closing exchange rate at reporting date. Foreign exchange gains and losses arising from foreign currency fluctuations are recognized in profit or loss for the period.

Subsequent events

All post year-end events up to the date the financial statements are authorized for issue that provide additional information about the System's position at reporting date (adjusting events) are reflected in the financial statements. Any post year-end event that is material and not an adjusting event is disclosed in the notes to the financial statements.

Borrowing costs

Borrowing costs are generally expensed as incurred. Borrowing costs that are directly attributable to the acquisition, development, improvement and construction of fixed assets (including costs incurred in connection with rehabilitation works) are capitalized as part of the cost of the asset. The capitalization commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Capitalization of borrowing costs ceases when substantially all activities necessary in preparing the related assets for their intended use are complete.

Judgments and use of estimates

The preparation of the accompanying financial statements in conformity with PFRS requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from such estimates.

Use of estimates

Key assumptions concerning the future and other sources of estimation and uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Estimating allowance for doubtful accounts

The System maintains allowances for doubtful accounts at a level considered adequate to provide for potential losses on receivables. The level of this allowance is based on management's evaluation of collection experience and other factors that may affect collectability. The amount and timing of recorded expenses for any period would, therefore, differ depending on the judgments and estimates made for the year.

Estimated useful lives of property, plant and equipment

The System estimates the useful lives of its property, plant and equipment based on the period over which the assets are expected to be available for use. The System reviews annually the estimated useful lives of property, plant and equipment based on factors that include asset utilization, internal technical evaluation, technological changes, environmental and anticipated use of the assets tempered by related industry benchmark information. It is possible that future results of operation could be materially affected by changes in the System's estimates brought about by changes in the factors mentioned.

Contingencies

Contingent Liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the financial statements but are disclosed when an inflow of economic benefits is probable. Contingent assets are not recognized unless virtually certain.

5. CASH AND CASH EQUIVALENTS

The account consists of the following:

Particulars	2014	2013
Cash on Hand	544	502
Cash in Bank- Savings & Current Account	120,958	137,413
Money Market Placements - Time Deposits	2,326,466	2,258,594
Total Cash & Cash Equivalent	2,447,968	2,396,509

a. Cash on Hand - This consist of the amount of collection with the Cash Collecting Officers, amount of cash advances granted to designated Regular/Special Disbursing

Officers for payment of authorized official expenditures subject to liquidation and cash granted to Petty Cash Custodians for payment of authorized petty and miscellaneous expenses which cannot be conveniently paid thru check.

b. Cash in Bank -

(i) Local Currency, Current Account - This consist of cash in local currency deposited in current account with the Land Bank of the Philippines (LBP) and Philippine National Bank (PNB) which earn interest at respective bank deposit rates. It includes PNB COMBO accounts which allow the simultaneous opening and linking of the Current account and the Savings account. It has a provision for the automatic transfer of funds from the savings account to the checking account to cover the amount of checks issued.

(ii) Cash in Bank - Local Currency, Savings Account - This consist of cash in local currency deposited in savings account with the Development Bank of the Philippines (DBP), LBP and PNB which earn interest at respective bank deposit rates. It includes PNB COMBO accounts which allow provision for the automatic transfer of funds from the savings account to the checking account to cover the amount of checks issued.

Portion of the Special Savings Account deposited with the DBP amounting to P192,491,268.91 was garnished by the Bureau of Internal Revenue on April 29, 2015.

(iii) Cash in Bank – Foreign Currency, Savings Account - This represents balances of cash in foreign currency, deposited in savings account with the Bureau of Treasury, LBP and PNB.

(iv) Cash in Bank – Foreign Currency, Time Deposit - This consists of placements in foreign currency time deposit with LBP and PNB.

c. Money Market Placements - These consist of placements in local currency time deposits with DBP, LBP, and PNB and are made for varying period.

6. ACCOUNTS RECEIVABLES, NET

This account consists of:

	2014	2013 (As restated)
Trade/business		
Receivables from customers-water, sewer, including raw water accounts	**1,123,077**	1,122,733
Receivables from concessionaires	**299,706**	265,296
	1,422,783	1,388,029
Allowance for doubtful accounts	**(1,117,002)**	(1,117,002)
	305,781	271,027
Non-trade receivables		
Intra-agency receivables	**158,990**	994,634
Inter-agency receivables	**15,486**	14,694
Due from officers and employees	**39,610**	41,512
Loans receivables	**51,895**	52,889
Interest receivables	**2,460**	3,518
	268,441	1,107,247

	574,222	1,378,274

The *Receivables from customers-water, sewer, including raw water* accounts represent the balance of accounts receivables prior to the privatization of MWSS in the amount of P1.117 billion, the collection of which is highly improbable. Thus, Management set-up the provision for bad debts account for the same amount. Meanwhile, Management is presently considering the process of writing-off the account in accordance with the required procedures , such as the congressional approval.

The *Receivables from concessionaires* represent concession fees for Current Operating Budget, Debt Service and Progress Billing that are outstanding as of balance sheet date.

Intra-agency receivables are receivables from the MWSS Regulatory Office consisting of electric bills.

Inter-agency receivables represent collectibles from other government agencies such as the Department of Public Works and Highways (DPWH), Office of the Government Corporate Counsel (OGCC), Supreme Court, Manila International Airport Authority (MIAA), Local Water Utilities Administration (LWUA) and the City of Manila for office rental, electric and water bills. Some of these accounts are classified as dormant. The Management created a task force to work out on all inactive and dormant accounts to be written –off in the books of account.

7. OTHER RECEIVABLES

This account consists of the following:	**2014**	2013 (As Restated)
Receivables from MWSI	**5,693,588**	5,647,357
Receivables from MWCI	**124,600**	138,750
Others	**13,384**	43,057
	5,831,572	5,829,164

Details of the *Receivables from MWSI and MWCI* are as follows:

	2014	2013
MWSI		
Cost of borrowings	**4,201,438**	3,952,833
Penalty on delayed remittance of Concession fees	**1,118,315**	1,118,315
Inventory held in trust	**158,480**	158,480
Penalty for non-payment of borrowing costs	**95,247**	95,247
Guarantee deposits	**94,996**	94,996
Mabuhay Vinyl	**4,994**	4,994
LMG Chemphil	**4,627**	4,627
Other receivables	**15,491**	217,865
	5,693,588	5,647,357
MWCI		
Guarantee deposits	**65,583**	65,583
Inventory held in trust	**43,748**	43,748

Penalty on delayed remittance of Concession fees	**-**	13,182
LMG Chemphil	**7,730**	7,730
La Vista	**591**	591
Other receivables	**6,948**	7,916
	124,600	138,750

Cost of borrowings include the principal, interest and finance charges such as bank conversions, documentary stamps, cable charges and penalties. MWSS is still pursuing the disputed claims on cost of borrowings from MWSI relative to the BNP Paribas loan. Should MWSS be able to collect additional cost of borrowings, the said amount will be used to pay the loan with LBP/DBP Bonds Facility.

Penalty on delayed remittance of Concession fee is disputed by MWSI. On December 19, 2007, the Rehabilitation Court issued an order, Special Proceeding No. Q-03-071 disallowing the penalty and the Order was confirmed on February 6, 2008. In a letter dated February 13, 2012, MWSS has requested the Commission on Audit's approval for the dropping out of the subject account from the books based on the order of the rehabilitation court.

Inventory held in trust represents costs of inventories turned-over to the concessionaires upon commencement of the Concession Agreement. Under Sec.16.12 of the Concession Agreement, upon the expiration of the Concession, the Concessionaires shall transfer to MWSS the inventory having a value (adjusted for CPI) at least equal to the Inventory made available to the Concessionaire on the Commencement Date.

Guarantee deposits are customer deposit prior to the privatization of MWSS. The amounts were withheld by the two concessionaires from the collection of accounts receivable from water and sewer services of MWSS on the onset of the privatization where the two concessionaires were authorized to collect. Management and the two concessionaires went into reconciliation to arrive at the amount of guarantee deposit to be refunded to MWSS, where MWCI refunded the amount of P6.6M in 2011. The said amount is being contested by MWSS. The amount to be refunded by MWSI was also established, however to date, MWSI has not remitted the amount due from them.

8. PREPAYMENTS

This account consists of the following:	**2014**	2013 (As Restated)
Advances to suppliers/contractors	**284,370**	284,438
Prepaid expenses	**27,605**	18,630
	311,975	303,068

Advances to suppliers/contractors include the balance of the 15 percent mobilization costs paid to the contractors/suppliers/consultants of civil works/goods/consultancy services, subject to periodic recoupment during the billing period and project implementation.

9. PROPERTY, PLANT AND EQUIPMENT, NET

The details of property, plant and equipment (PPE) are as follows:

	Building & Structures	Office Furniture and Other Equipment	Trans-portation Equipment	Land & Land Improve-ments	TOTAL
Cost					
January 1, 2014	61,452,836	671,928	456,104	12,405,416	74,986,284
Additions	-	345	-	6,821,069	6,821,414
Adjustments	110	(8,179)	5,928	-	(2,141)
Transfers/Capitalization	6,340,093	148,598	54,945	-	6,543,636
December 31, 2014	67,793,039	812,692	516,977	19,226,485	88,349,193
Accumulated Depreciation					
January 1, 2014	38,774,805	567,943	321,724	-	39,664,472
Addition	1,229,852	142,454	60,657	-	1,432,963
Adjustments	(110)	(13,821)	(4,610)	-	(18,541)
December 31, 2014	40,004,547	696,576	377,771	-	41,078,894
Carrying Amount December 31, 2014	**27,788,492**	**116,116**	**139,206**	**19,226,485**	**47,270,079**
Cost January 1, 2013	61,459,438	219,718	321,964	12,791,301	74,792,421
Additions	-	34,427	-	1,042,739	1,077,166
Adjustments	(6,669)	169,542	134,140	(1,428,624)	(1,131,611)
Transfers/Capitalization	67	248,241	-	-	248,308
December 31, 2013	61,452,836	671,928	456,104	12,405,416	74,986,284
Accumulated Depreciation					
January 1, 2013	37,507,077	180,159	171,375	-	37,858,611
Depreciation Addition	1,267,728	13,747	22,294	-	- 1,303,769
Adjustments	-	374,037	128,055	-	502,092
December 31, 2013	38,774,805	567,943	321,724	-	39,664,472
Carrying Amount December 31, 2013, As Restated	**22,678,031**	**103,985**	**134,380**	**12,405,416**	**35,321,812**

Included in the account are assets classified as Investment Property with carrying value of P96,417,581.95 which will be recorded in the books as Investment Property once the

COA Government Accountancy Sector grant the authority under the e-NGAS to open said account.

Pursuant to the MWSS Agency Action Plan and Status of Implementation (AAPSI) on the CY 2013 Financial Statements to address the findings of the Commission on Audit, MWSS shall engage an independent appraiser to update the valuation of the agency's Property, Plant and Equipment. The Terms of Reference for the engagement is currently undergoing review by the MWSS Technical Working Group. Efforts to validate the agency's PPE records through a comprehensive documents review and an actual physical inventory of all properties are also ongoing.

10. CONSTRUCTION IN-PROGRESS

The movements in this account follow:

	2014	2013
Balance, beginning	**6,401,373**	5,774,051
Additions/New Project	**109,710**	638,935
Transfers/capitalization	**(6,353,587)**	0
Reclassification/Adjustments	**0**	(11,613)
Balance, end	**157,496**	6,401,373

The decrease in *Construction in Progress* was due to capitalization of amounts relating to the completed Angat Water Utilization and Aqueduct Improvement Project (AWUAIP) to the appropriate property plant and equipment account.

11. INVESTMENTS

This account consists of the following

	2014	2013
Held to maturity/Special reserve fund	**369,457**	354,914
Sinking fund	**29,510**	29,510
	398,967	384,424
Stocks and bonds		
MERALCO stocks	**2,152**	2,152
PLDT investment plan	**373**	373
	2,525	2,525
	401,492	386,949

The special reserve fund with the Bureau of Treasury, which is intended as guarantee for the financial obligations of MWSS during the concession period, was established pursuant to Article 2.1 of the Memorandum of Agreement (MOA) between the DOF and MWSS.

12. OTHER ASSETS, NET

This account consists of the following:

	2014	2013 (As Restated)
Unserviceable assets	**121,450**	264,672
Research and development	**6,212**	6,212
MWSS Share in Angat Dam construction	**22,406**	30,529

Garnished accounts	**10,614**	10,614
Guarantee deposits	**25,452**	10,728
Dormant accounts	**688,359**	688,359
For reclassification -Investment Property	**593,706**	0
TOTAL	**1,468,199**	1,011,114

Unserviceable assets are the costs of land, construction materials and supplies that can no longer be used in projects due to obsolescence or assets which are no longer operational.

The reclassification to Investment Property of the amount of P593,706,416 will be made when the COA Government Accountancy Sector approved the opening of the accounts in e-NGAS.

13. ACCOUNTS PAYABLE

This account consists of:	**2014**	2013 (As Restated)
Accounts payable	**105,119**	41,027
Interest payable	**115,496**	120,214
Dividends Payable	**29,248**	223,318
Due to officers and employees	**48,428**	568
	298,291	385,127

Accounts payable includes accrued maintenance and other operating expenses and local counterpart of loans payable.

Due to officers and employees refers to accrued personal services to be paid the following year.

14. INTER-AGENCY PAYABLES

This account consists of payables to the:

	2014	2013 (As Restated)
Bureau of Treasury	**111,300**	233,517
Bureau of Internal Revenue	**6,705**	32,118
GSIS	**1,328**	(920)
Pag-IBIG	**168**	43
Other GOCCs	**70**	(435)
	119,571	264,323

Payable to the Bureau of Treasury pertains to the guarantee fee on existing loans. Other GOCCs include Philhealth and National Home Mortgage and Financing Corporation.

15. INTRA-AGENCY PAYABLE

This account represents the share of the MWSS-Regulatory Office in the concession fee received from the concessionaires for their current operating budget as provided in the CA.

In Board Resolution No. 2014-041 CO dated April 24, 2014, the Board of Trustees upon representation made in the Memorandum to the Board dated March 10, 2014, and the joint recommendation of the MWSS-CO and RO, adopted and approved the following policy determination and declaration on the Reciprocal Accounts between CO and RO:

1. Policy Determination: The Concession Agreements mandated the establishment of a Regulatory Office (RO) as the unit that shall discharge purely regulatory powers and functions contractually stipulated under Sections 7 and 8, Exhibit A, of the said Agreements. The RO does not possess a legal or juridical personality separate and distinct from the MWSS. Article 11.1 of the Concession Agreements mandate the operational independence of RO in that *"Decisions of the Regulatory Office requiring action by the MWSS Board of Trustees, including decisions affecting the* level of Standard Rates, shall promptly be submitted to the Board in accordance with Section 7.1 hereof." Stated differently, the RO reports directly to the Board and need not pass through nor seek the prior approval, consent, or conformity of the MWSS Administrator before it is able to elevate a matter to and for disposition by the Board.

The RO is a cost-center and not a revenue-generating unit of MWSS CO. The RO was not given any substantial assets that can be used to generate revenue or to encumber/secure loans nor was it granted the power to raise revenues from licenses, fees and charges. The obligation of the MWSS under Article 11.2 of the Concession Agreements is to provide the RO an approved annual operating budget that must be allocated on or before January 10 of each year to enable the latter to discharge its mandated powers and functions. The obligation to remit 50% of the concession fees to RO was peculiar and particular only for 1997 which was the first year of the Concession Agreement. For subsequent years, the RO shall be allocated an annual operating budget that shall not exceed 50% of the Concession Fees remitted by the concessionaires. The test, therefore, is not in the percentage share of Concession Fees but in the sufficiency of the annual budget approved by the Board that should enable the RO to meet its obligations, plans, programs, projects, and activities for the calendar year.

That, in years past, MWSS CO was not able to remit to RO the amounts needed to complete the 50% share in Concession Fees did not create a legally enforceable obligation or receivable account. That, in years past, RO was not able to fully utilize or allocate its budgetary releases did not result in income but only budgetary surplus for that calendar year.

2. Policy Pronouncement: The Board also resolved, adopted and approved the following budgeting principles, that:

> 2.a. The distribution and allocation of Concession Fees (CFs) between MWSS CO and the RO will be in accordance with their Board-approved Corporate Operating Budget for the calendar year subject to the limit and release schedule stipulated in Article 11.2 of the Concession Agreements (CA).
>
> 2.b. To bolster the operational independence of RO under Article 11 of the CA, the MWSS should endeavor to seasonably approve the COB so that the stipulated January 10 deadline for the remittance of RO's COB can be faithfully complied with. Should, however, the MWSS fail to seasonably approve RO's COB, one half (½) of the immediately preceding calendar year's Board-approved budget for Personnel Services (PS) and Maintenance and Other Operating Expenses (MOOE) should be remitted to RO

in compliance with the January 10 deadline stipulated in the Article 11.2 of the CA. The balance should be seasonably released to RO as soon as the Board approves its COB.

2.c. Toward the calendar year's end, the RO budget utilization and other year-end financial reports will be consolidated with that of MWSS and reported to the Board for determination and approval of any dividends and taxes that may be remitted to the National Government pursuant to law. As a purely regulatory office, any undisbursed, unallocated, or unencumbered budget will be reported to the Board for appropriate disposition.

On February 20, 2015, the Office of the Government Corporate Counsel in a Memorandum addressed to the MWSS Board of Trustees, copy furnished the Chief Regulator of the Regulatory Office, confirmed that the MWSS BOT Resolution 2014-041-CO correctly reflects the letter and intent of the CAs, and is consistent with the MWSS BOT'S overarching duty, as fiduciaries of the State, to ensure the efficient and rational use of public funds.

16. OTHER LIABILITY ACCOUNTS

This account includes 10% retention from contractors' claims, unreturned borrowed materials, cost of flushing, attorneys' fees, guaranty deposits and depository liabilities. It also includes liabilities with existing law suits and money claims.

17. LONG-TERM LIABILITIES /CURRENT PORTION

This account consists of loans payables for domestic and foreign borrowing, as follows:

Source	Maturity Date	Currency	Annual Interest Rate	2014	2013
Domestic loans					
DBP/LBP	12/31/18	P	4.50%	**1,044,643**	1,366,071
SPIAL	05-15-26	$	9.65%	**189,706**	355,626
ADB 1746-PHI	02-01-22	P	floating	**197,073**	196,176
NHA		P	floating	**98,795**	98,795
IBRD 1272/1282	07-15-20	$	8.50%	**64,437**	64,144
				1,594,654	2,080,812
Foreign loans					
ADB 1379-PHI	07-15-20	$	floating	**1,986,611**	2,208,587
ADB 986-PHI	10-01-14	$	floating	**-**	561,753
JBIC (OECF)	02-20-20	Y	2.70%	**1,275,243**	1,458,649
IBRD 4019-PH	07-01-16	$	floating	**225,326**	362,429
China Eximbank AWUAIP II	01-21-30	$	libor rate	**5,145,691**	5,122,279
ADB 1150-PHI	10-15-16	$	floating	**86,657**	141,852
French Protocol	12-31-18	FF	3%-6.8%	**28,300**	56,369
IBRD 4227 PHI	09-15-17	$	floating	**23,864**	30,906
				8,771,692	9,942,824
Total				**10,366,346**	12,023,636

Current Portion -			
Asian Development bank (ADB)			
1379	232,071		
1150	37,359	**269,430**	835,500
Int'l. Bank for Reconstruction & Development (IBRD)			
4019	138,759		
4227	7,567	**146,326**	142,160
French Protocol		**22,065**	24,695
Special Project Implementation Assistance Loan (SPIAL)		**11,749**	11,695
		449,570	1,014,050
Non-Current Portion		**9,916,776**	11,009,586

On February 10, 2011, the MWSS Board of Trustees unanimously passed Board Resolution no. 2011-017 approving the *P2.250 billion floating rate Bond Issuance under the DBP-LBP Club deal Arrangement.* The bond issuance was guaranteed by the National Government. The proceeds were used to partly finance the MWSS' maturing 7-year USD 150M 9.25% Fixed rate Bond with the BNP Paribas which matured last March 14, 2011. The bond was drawn in full on March 30, 2011 and payable in seven (7) years with pre-termination option. Interest rate was based on the higher of the BSP Reverse Repurchase (RRP) Facility or BSP Overnight Borrowing Rate.

The *Special Project Implementation Assistance Loan* (SPIAL) is a portion of the National Government's multi-currency loans from the ADB under Loan Nos. 779 & 780. This was relent to MWSS to partly finance the following projects: Manila Water Supply Rehabilitation Project I (MWSRP I), Manila Water Supply Project II (MWSP II), and Metro Manila Sewerage Project (MMSP).

ADB Loan No. 1746 PHI is a sub-loan agreement entered into by and between the Department of Finance and the MWSS on October 13, 2003 for the implementation of the Pasig River Environmental Management and Rehabilitation Sector, a sanitation component of the loan.

NHA Loan financed the transfer of water and sewer systems of Tondo Foreshore, Dagat-Dagatan and Kapitbahayan and was transferred by NHA to MWSS before the privatization. The validity of the account is still subject to confirmation and subsequent preparation of MOA between MWSS, NHA and the two concessionaires.

International Bank for Reconstruction and Development (IBRD) Loan No. 1272/1282-Manila Urban Development Project is likewise a national government loan relent to MWSS on October 1, 1976. Per subsidiary loan agreement dated October 1, 1976, MWSS shall repay the principal of the subsidiary loan starting November 15, 1981.

ADB Loan No. 1379 PHI was obtained on November 27, 1995. The primary objectives of the project financed by this loan were to divert an average annual flow of about 15.7 cubic meters per second from the Umiray river basin to the Angat reservoir and to augment the treated water supply capacity of MWSS by about nine cubic meters per second by 1999. The secondary objective of the project was to reduce Non Revenue Water (NRW) by providing support for leak detection and repair activities. It is a twenty (20) year loan with a grace period of five (5) years which will mature on July 15, 2020.

ADB Loan No. 986 PHI– Angat Water Supply Optimization Project was obtained on December 18, 1989. The objectives of the project were to maximize the capacity of the main water supply source of the MWSS and to meet projected water demand in the project area through construction of additional supply, treatment and distribution facilities. It is a twenty (20) year loan with a grace period of five (5) years. The loan matured on October 1, 2014.

JBIC (OECF) – refers to JBIC Loan PH 110 that was contracted by Japan and the national government of the Republic of the Philippines in 1990 for the Angat Water Supply Optimization Project. Amortization for the NG loan commenced in 2001; however, no billings have been received by MWSS for the loan to date. In 2004 and 2005, MWSS forwarded payments to the BTR in relation to these loans in the amounts of P200M and P111.32M, respectively.

IBRD Loan No. 4019 PH - Manila Second Sewerage Project - was obtained on June 19, 1996. The objectives of the project were to assist the Borrower to a) reduce the pollution of Metro Manila waterways and Manila Bay; b) reduce the health hazards associated with human exposure to sewerage in Metro Manila; and c) establish a gradual low-cost improvement of sewerage services in Metro Manila by expanding the Borrower's septage management program. It is a fifteen (15) year loan with a grace period of five (5) years which will mature on July 1, 2016.

China Eximbank - Angat Water Utilization and Aqueduct Improvement Project Phase II (AWUAIP-II) is being financed through a loan from the Export-Import Bank of China on May 7, 2010 in the amount of US$116,602,000. The Angat Water Utilization and Aqueduct Improvement Project Phase 2 is an offshoot of the Angat Water Utilization and Aqueduct Improvement Project (AWUAIP). To be implemented by the MWSS, the AWUAIP is targeted to maintain and optimize the water conveyance from Angat Dam to the Water Treatment Plants via the Ipo Dam-Bicti-La Mesa Portal system. The project involves the rehabilitation of AQ-5, which supplies half of the raw water for Metro Manila, as well as the construction of AQ-6 in order to recover around 394 million liters of raw water lost to leakages. AWUAIP Phase 2 on the other hand involves the construction of the remaining 9.9 km section of AQ-6, and the rehabilitation of AQ-5. The AQ-6 extension aims to completely recover the lost water due to leakages in AQ-5. Repayment period is fifteen (15) years on a semi-annual basis starting January 21, 2015. The loan will mature on January 21, 2030.

ADB Loan No. 1150 PHI – Manila South Water Distribution Project – was obtained on January 23, 1992. The primary objective of the project financed by the loan was to improve the water supply services of MWSS in the project area. The secondary objective was to reduce the use of ground water, to prevent saline intrusion and land subsidence, as the main source of water for the remaining population not served by MWSS in the project area. It is a twenty (20) year loan with a grace period of five (5) years which will mature on October 15, 2016.

The French Protocol is a Treasury Credit Facility from the French Republic intended to finance the implementation of the Rizal Province Water Supply Improvement Project (RPWSIP) payable within a period of ten (10) years that started in December 2002.

IBRD 4227 PHI was part of the Water Districts Development Project funded by a loan from the World Bank-IBRD. MWSS entered into a subsidiary loan agreement with the

Republic of the Philippines through the Department of Finance for $2.3 Million from said IBRD loan. Repayment period is 15 years on a semi-annual basis starting March 15, 2003 and ending on September 15, 2017 per Schedule 3 of the Loan Agreement between the Republic of the Philippines and the International Bank for Reconstruction and Development dated May 15, 1999.

18. DEFERRED CREDITS

This account consists of:

	2014	2013 (As Restated)
Deferred credits to income - COB	**725,843**	1,426,767
Deferred credits to Income – Penalty/Interest. on delayed payment of Concession Fee & borrowing costs	**1,213,562**	1,213,562
Others	**97,660**	97,514
	2,037,065	2,737,843

Deferred credits to income- COB account represents annual concession fee – corporate operating budget received in advance from concessionaires pursuant to the concession agreement. Said account is allocated equally over a period of twelve months to the appropriate income account. Deferred credits to Income – Penalty/Interest on delayed payment of Concession Fee is the penalty previously charged to MWSI computed based on 364 T-bill rate. The amount was disallowed by the Rehabilitation Court in Court Order approving the Prepayment and Settlement Agreement (PSA) dated December 19, 2007 and Court Order confirming the termination of the corporate rehabilitation proceedings on account of successful implementation of the 2005 Revised Rehab Plan dated 6 February 2008. Proposal for write off of this account has already been forwarded to COA in a letter dated February 13, 2012.

19. DONATED CAPITAL

This account represents the costs of waterworks facilities turned-over by private subdivisions by way of a Deed of Donation. It also includes the grant from the Japan International Cooperation Agency (JICA) for the rehabilitation of Balara Water Treatment Plant.

20. PERSONAL SERVICES

This account is comprised of the following:

	2014	2013 (As Restated)
Salaries and wages – regular	**71,190**	73,513
Productivity incentive allowance	**9,611**	8,164
Life and retirement insurance contributions	**8,510**	8,858
Cash gift/13th month pay	**6,783**	7,005
Other personnel benefits	**6,102**	4,201
Subsistence, laundry & quarter allowance	**4,540**	9,957
PERA	**4,118**	4,351

Representation allowance	**3,972**	10,469
Transportation allowance	**2,629**	3,441
Honoraria	**2,627**	2,797
Provident fund benefit	**1,505**	3,579
Clothing allowance	**855**	925
Terminal leave benefits	**816**	3,302
PHILHEALTH contributions	**790**	703
Hazard pay	**649**	1,840
Other bonuses and allowances	**273**	4,980
ECC contributions	**208**	218
Pag-IBIG contributions	**196**	218
Salaries and wages - contractual	**149**	55
Longevity pay	**1**	6,834
	125,524	155,410

21. MAINTENANCE AND OTHER OPERATING EXPENSES

This account consists of the following:

	2014	2013 (As Restated)
Legal Services	**80,577**	88
Security services	**22,711**	23,432
Auditing services	**8,320**	9,022
Electricity expenses	**4,834**	7,392
Taxes, duties and licenses	**6,258**	6,628
Other professional services	**3,633**	6,750
Janitorial services	**2,532**	3,781
Consultancy expenses	**59**	3,283
Communication expense	**2,331**	2,317
Other maintenance and operating expenses	**2,019**	741
Insurance expense	**2,762**	2,141
Office supplies expenses	**2,924**	1,896
Training expenses	**1,949**	1,650
Extraordinary and miscellaneous expenses	**1,386**	861
Gasoline, oil and lubricants	**1,890**	1,496
Representation expenses	**1,132**	1,125
Advertising expenses	**1,153**	673
Repairs and maintenance	**934**	876
Rent expense	**711**	584
Other supplies expenses	**471**	591
Donations	**15**	247
Water expenses	**259**	143
Subscription expenses	**121**	141
Fidelity bond premiums	**57**	124

Printing and binding expenses	**513**	99
Travelling expenses	**47**	85
Membership dues and contributions to organization	**70**	80
Drugs and medicines expenses	**94**	54
Postage and deliveries	**34**	17
	149,796	76,317

22. FINANCIAL EXPENSES

This account consists of:

	2014	2013 (As Restated)
Interest expenses	**223,295**	172,495
Other financial charges	**53,673**	46,262
Bank charges	**104**	51
	277,072	218,808

23. SUBSEQUENT EVENTS

MWSS implemented Rate Adjustments for Manila Water and Maynilad

The MWSS Board of Trustees approved a downward adjustment of 2.42% for MWCI per Board Resolution No. 2015-058-RO dated May 8, 2015; and an upward adjustment of 4.19% for MWSI per Board Resolution No. 2015-060-RO dated May 14, 2015; respectively which will be effective June 1, 2015.

The average water charge of MWCI is seen to go down by P0.63 per cu.m. while that of MWSI is expected to go up by P1.35 per cubic meter.

The rate adjustment for MWCI is the net effect of the implementation of the annual inflation adjustments that were suspended for 2014 and 2015, the provisional rate increase of 3.2% in 2013, and the implementation on the Final Award in the arbitration between MWSS and MWCI.

The rate adjustment in MWSI water charges is attributed to two factors: 1.) On 7.52% increase in the average basic charge or P2.35 per cubic meter due to the implementation of the annual inflation adjustments that were suspended for 2014 and 2015; and 2.) A decrease in water charges due to the discontinuance of the P1.00 per cubic meter CERA.

BTR transferred to MWSS Account P553 million for the implementation of Strenghening of Angat Dam and Dyke

On February 17, 2015, the Department of Budget and Management in a letter addressed to the Treasurer of the Philippines instructed the transfer of the amount of P553M to the MWSS-CO chargeable against NCA No. BMB-F-12-0025139. Such funds shall be used to cover partly the cash requirements of SARO No. F-12-01369 dated December 20, 2012 for the implementation of Strengthening of Angat Dam and Dyke of MWSS particularly for packages for: 1.) Instrumentation (Flood Forecasting and Warning System on Dam Operation); and 2.) Flow Control Protection Works.

Said amount shall be transferred to the account of the NPC and the Province of Bulacan which will implement the above packages to be monitored by MWSS.

Adoption of the Philippine Public Sector Accounting Standards (PPSAS) in compliance with COA Circular 2015-003 dated April 16, 2015 in succeeding years.

COA Circular 2015-003 classified all government corporations and other entities with corporate powers as Government Business Enterprise (GBE) or Non-GBE for the purpose of determining the applicable Financial Reporting Framework in the preparation of their Financial Statements and prescribing guidelines therefor.

MWSS is classified as Non-GBE and shall apply the PPSAS pursuant to COA Resolution No. 2014-003.Specific guidelines on the conversion and reconciliation of the converted accounts shall be prepared by the Government Accountancy Sector in consultation with the COA Corporate Government Sector and the concerned government entities.

24. CONTINGENT LIABILITIES

MWSS is contingently liable for lawsuits or claims filed by third parties which are either pending in the courts or under negotiations. These cases involve, among others, lease of properties, collection of sum of money, water use conflict issues, payments of claims and protest on real property taxes**.**

1. BIR Tax Assessment

   BIR assessed MWSS' withholding tax for year ending December 31, 2009. As early as February 1, 2010, MWSS had already filed its tax return with the BIR. On September 15, 2010, it received from the BIR a letter request for the presentation of the required books of accounts and other accounting records in relation to the September 15, 2010 Letter of Authority 039-2010-0000173.

   The BIR initially on August 13, 2014 issued Preliminary Assessment Notice (PAN) 39-B042-09 to MWSS for the latter's alleged deficiencies in the expanded withholding tax, withholding tax on compensation and withholding tax on VAT for year ending December 31, 2009. Thereafter, MWSS replied through its counsel strongly disputing the assessment based on prescription as it was issued beyond the 3 year period of limitation provided under Section 203 and 222 of the 1997 National Internal Revenue Code (NIRC), as amended.

   Two more issuances followed the PAN, specifically the February 13, 2014 Preliminary Collection Letter (PCL), which MWSS received on February 26, 2015, and February 23, 2015 Final Notice Before Seizure (FNBS), which MWSS received only on March 4, 2015. Again on March 23, 2015 BIR issued a Warrant of Distraint and Levy. Thereafter, on April 21, 2015, BIR served a Warrant of Garnishment upon MWSI and MWCI on MWSS' receivable accounts, and such other property in the possession and control of the concessionaires.

   On April 29, 2015, after conference, BIR lifted the Garnishment from MWSI and MWCI replacing them with MWSS' assets in the custody of the Development Bank of the Philippines (DBP). Meanwhile, on May 20, 2015, MWSS filed Petition for Review (Ad Cautelam with Urgent Motion to Suspend Tax Collection) with the Court of Tax Appeals. As of June 2015, the garnishment issued to the DBP has not been lifted.

2. The System has pending court litigations concerning project contracts and land disputes totaling P29.71M prior to its privatization in 1997. The MWSS has also disputed the real estate taxes charged by the local government of Quezon City in the amount of P264M. In 2010, the Quezon City government auctioned some of the properties located in the area. To prevent the inclusion of MWSS property in the auction held in December 2010, the System deposited P30M. The legal issues on the matter are elevated before the Supreme Court and subsequently a temporary restraining order (TRO) was issued on January 21, 2011 enjoining Quezon City government from proceeding with the levy of the subject properties until further orders from the court.

3. Other significant legal cases are as follows:

- Gabriel Advincula vs MWSS; GR 179217, Re: Severance Pay
- Alexander Lopez, et al vs MWSS, GR 198693, Re: Contract Collectors Claim
- CSC vs MWSS; indirect Contempt on Alexander Lopez, et.al., Separation Pay and Terminal Leave of Contract Collectors
- Various cases regarding Unlawful Detainer on Land Properties of MWSS

25. REPORT ON THE SUPPLEMENTARY INFORMATION REQUIRED UNDER REVENUE REGULATION NO. 15-2010

In compliance with the above regulation, MWSS' taxes and withholding taxes paid and accrued during the year are categorized as follows:

1. VAT Output Tax

MWSS is a VAT registered company with VAT Output Tax declaration of Php12,501,722.29 for the year based on the amount reflected in the Income/ Receivables Account of Php104,181,019.03.

2. VAT Input Tax

The amount of VAT Input taxes claims are broken down as follows:

Particulars	Amount
Beginning of the year	337
Current year's purchases	6,514
Total	6,851
Claim for Tax credits and other adjustments	7,137
Input VAT for 2015 (January)	286

3. Other Taxes and Licenses

Particulars	Amount
Local	
Community Tax	1
Other Taxes and Licenses	6,227
BIR Registration Fee	1
BTr (Fidelity Bond)	30
Total	6,259

4. The amount of withholding taxes categorized into:

Particulars	Amount
i. Tax on Compensation and Benefits	15,957
ii. Creditable Withholding Tax/es	1,000
iii. Final Withholding Tax/es	1,000
iv. Expanded Withholding Tax/es.	37,068

5. Preliminary Assessment Notice

As discussed in Note 24 above, MWSS has received a Preliminary Assessment Notice from the Regional Office of BIR covering the taxable year 2009 amounting to P192M, inclusive of penalties, for deficiency income/VAT/Percentage/Withholding Tax. On May 20, 2015, MWSS filed Petition for Review (Ad Cautelam with Urgent Motion to Suspend Tax Collection) with the Court of Tax Appeals.

26. UNRECONCILED ASSET AND LIABILITY ACCOUNT BALANCES

The unreconciled balances in the Asset and Liability accounts were taken up in one comprehensive account to be able to monitor the reconciliation being done by the System. The outcome is as follows:

Particulars	2014	2013
Asset Accounts		
Accounts Receivable	21,718	21,718
Other Receivables	1,108	1,108
Prepayments	96,742	101,290
Property, Plant and Equipments	(26,286)	14,324
Construction in Progress	457,019	457,019
Other Assets	(19,576)	(19,576)
Total Unreconciled Assets	530,725	575,883
Liability Accounts		
Payable Accounts	533,803	582,802
Inter-Agency Payable	-	4,789
Other Liability Account	328,114	328,114
Deferred Credits	22,633	22,633
Total Unreconciled Liabilities	884,550	938,338
Equity Account		
Capital Stock	-	281
Total Unreconciled Equity	-	281
Net Unreconciled Balances	353,825	362,736

27. RESTATEMENT OF RETAINED EARNINGS as of January 1, 2013

In compliance with PAS 8 (Accounting Polices, Changes in Accounting Estimates and Errors, the Retained Earnings as of January 1, 2013 has been restated as follows:

Unrestated Balance, January 1, 2013	**680,608**
Adjustments:	
Closing of Unclaimed Benefits	58,681
Payment of 2012 Dividends	(84,070)
Payment of 2008 COLA Back Claims	(420)
GSIS Underremittance	(29)
Depreciation of AWUAIP vehicles 2010-2012	(4,193)
Adjustment RA 1616	2,512
Transaction Adjustment-Cost of Land 1984	(39,032)
CO/RO Shared Expenses	(137,347)
2012 Understatement of Expenses	(2,228)
2005 Collection of Interest/Penalty	13,182
Inter Agency Payable	2,048
Closing of Other Payables	65,271
Adjustment of Deferred Credits-AWUAIP	414,282
Adjustment of UPNEC PAWS II Y4	(2,596)

Adjustment of CRJ Aug 2012 on PAWS Payment	2,620
Cash Receipts for Sept 2004	2
R. Coloso – loyalty award	(15)
Reversal of Excess Accrual	140,571
Reversal of Accounts Receivable	(245,069)
Compliance to 2013 COA Findings on PPE	8,961
Compliance to COA Finding on IT Equipment – PAWS Project	(50,219)
Adjustment of Depreciation	(240)
Income/Expense Adjustments	(1,326)
Prior Years' Rentals	(5,057)
Adjustment of Concession Fee	(16,062)
Adjustment of PPE	(33,381)
Adjustment of Construction in Progress	(11,545)
Dividends Paid	(300,000)
Adjustment of Contingent Liabilities	180,364
Reversal of Accruals	683
Total	**(43,652)**
Retained Earnings, January 1, 2013 (As Restated)	**636,956**