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COMMONWEALTH INSURANCE COMPANY

FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

The table below presents the financial assets and liabilities whose carrying amounts approximate their fair values as at December 31, 2019 and 2018:

	2019	2018
Financial Assets		
Cash and cash equivalents	P 752,454,323	P 1,034,262,352
Short-term bank investments	281,904,229	44,376,992
Insurance balances receivable	760,791,769	561,527,185
Claims and losses recoverable	23,064,520	62,460,494
Accrued investment income	5,245,485	5,017,346
Other assets	4,890,590	6,302,724
	P 1,828,350,916	P 1,713,947,093
Financial Liabilities		
Insurance claims payable	P 131,361,889	P 120,683,972
Reinsurance liabilities	14,585,630	16,249,931
Accounts payable and accrued expenses*	83,705,770	144,060,701
	P 229,653,289	P 280,994,604

* Excluding nonfinancial liabilities amounting to P353,413,083 and P205,949,341 in 2019 and 2018, respectively.

- *Current financial assets and liabilities.* The carrying values of cash and cash equivalents, short-term bank investments, insurance and reinsurance receivables, accrued investment income, accounts payable and accrued expenses, reinsurance liabilities and insurance claims payable approximate their fair values due to the short-term nature of these financial instruments.
- *Noncurrent assets.* The carrying amount of other assets approximates their fair value. Management believes that the effect of discounting the future receipts from these instruments using the prevailing market rates is insignificant.

7. Management of Insurance risk, Financial risk and Capital

Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Company faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated.

Insurance events are random and the actual number and amount of claims and benefits will vary from year to year from the estimate established using statistical techniques. Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Company has developed its insurance underwriting strategy to diversify the type of insurance

On the same date, IC issued Circular Letter 2016-69 which relaxes the implementation of Circular 2016-67 and allows to set up premium liabilities the UPR instead of the higher of the UPR and URR and MfAD was conditionally set to 50% for the period of 2019 and 2018.

Financial Risk

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts. The most important components of this financial risk are credit risk, liquidity risk and market risk.

These risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The risk that the Company primarily faces due to the nature of its investments is interest rate risk.

Credit Risk

Credit risk is risk due to uncertainty in a counterparty's (also called an obligor) ability to meet its obligation.

Key areas where the Company is exposed to credit risk are:

- Reinsurers' share of insurance liabilities,
- Amounts due from reinsurers in respect of claims already paid,
- Amounts due from insurance contract holders, and
- Amounts due from insurance intermediaries.

The Company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments. Such risks are subject to an annual or more frequent review.

Limits on the level of credit risk by category and territory are approved quarterly by the reinsurance department. Reinsurance is used to manage insurance risk. This does not, however, discharge the Company's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Company remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an annual basis by reviewing their financial strength prior to finalization of any contract.

The table below shows the gross maximum exposure to credit risk of the Company as of December 31, 2019 and 2018.

	2019		2018	
Cash and cash equivalents*	P	637,800,455	P	921,001,014
Short-term bank investments		281,904,229		44,376,992
Financial Investments				
AFS - equity securities		172,091		177,245
HTM - gov't securities		1,111,864,104		939,156,730
Accrued investment income		5,245,485		5,017,346
Insurance balances receivable		760,791,769		561,527,185
Claims and losses recoverable		23,064,520		62,460,494
Other assets		4,890,590		6,302,724
	P	2,825,733,243	P	2,540,019,730

*Excludes cash on hand

9. Investments

The reconciliation of the carrying amounts of financial assets at the beginning and at the end of the year is shown below.

	December 31, 2019		
	AFS	HTM	Total
Balance, January 1	P 177,245	P 939,156,730	P 939,333,975
Acquisition	-	471,702,712	471,702,712
Sale/maturity	-	(300,123,173)	(300,123,173)
Changes in fair value	(5,154)	-	(5,154)
Amortization of premium/discount	-	1,127,835	1,127,835
Balance, December 31	P 172,091	P 1,111,864,104	P 1,112,036,195

	December 31, 2018		
	AFS	HTM	Total
Balance, January 1	P 235,299	P 698,565,302	P 698,800,601
Acquisition	-	570,145,498	570,145,498
Sale/maturity	-	(328,673,693)	(328,673,693)
Changes in fair value	(58,054)	-	(58,054)
Amortization of premium/discount	-	(880,377)	(880,377)
Balance, December 31	P 177,245	P 939,156,730	P 939,333,975

(i) Available-for-sale

Available-for-sale financial assets represent equity instruments with quoted and unquoted market values. For securities with no active market, the carrying amounts are stated at cost.

Analysis of equity instruments is as follows:

	2019		2018	
Acquisition cost:				
Quoted in the stock exchange	P	44,500	P	44,500
Not quoted in the stock exchange		21,270		21,270
		65,770		65,770
Fair value gain (loss):				
Quoted in the stock exchange		106,321		111,475
Carrying values	P	172,091	P	177,245

The net change in fair values over the acquisition cost is reflected in the Equity section of statement of financial position, net of related tax effect.

(ii) Held-to-maturity

Held-to-maturity financial assets represent debt instruments issued by the Philippine government and private corporations. The term of the issues ranges from 2 to 6 years and earns a coupon rate of 2.7% and 6.25% in 2019 and 2.7% and 7.875% in 2018.