# AUDIT OBSERVATIONS AND RECOMMENDATIONS

1. **The allowance for inventory obsolescence on unserviceable aircraft inventory is understated by P17.355 million, thus overstating the reported net realizable value (NRV) and understating expenses for CY 2015 by the same amount. Further, the gross balance of P69.944 million of aircraft parts inventory carried over to the Notes to Financial Statements is not reconciled with the balance in the 2015 Aircraft Spare Parts Inventory Report of P56.012 million, for a discrepancy of P13.932 million.**

International Accounting Standard (IAS) No. 2 requires that inventory items be measured at lower of cost or net realizable value (NRV). This necessitates that a periodic assessment of the items be conducted to determine their commercial value, and to provide an allowance for their obsolescence, if warranted.

Details and status of Aircraft Parts Inventories as of December 31, 2015 and 2014 are as follows:

|  |  |  |
| --- | --- | --- |
|  |  2015 | 2014 |
| *Unserviceable* | 40,913,857 | 42,258,425 |
| Serviceable | 13,442,940 |  7,101,208 |
| Repairable |  1,649,764 |  248,042 |
| Condemned |  5,126 |  |
|  Total  | 56,011,687 | 49,607,675 |

On the other hand, the Notes to the Financial Statements show:

|  |  |  |
| --- | --- | --- |
|  |  2015 |  2014 |
| Spare parts inventory |  69,943,744 |  64,926,656 |
| Jobs in progress |  8,244,759 |  8,244,759 |
| Total |  78,188,503 |  73,171,415 |
| Allowance for Obsolescence | (23,563,740) | (23,563,740) |
| Net Inventory |  54,624,763 |  49,607,675 |

As shown above, it may be deduced that the allowance for inventory obsolescence is under provided for by about P17,355,243 and P18,694,685 as of December 31, 2015 and 2014, respectively, computed as follows:

|  |  |  |
| --- | --- | --- |
|  | 2015 | 2014 |
| Unserviceable |  40,913,857 |  42,258,425 |
| Add: Condemned |  5,126 |  0 |
| Total |  40,918,983 |  42,258,425 |
| Less: Allowance for Obsolescence | (23,563,740) | (23,563,740) |
| Under Provision |  17,355,243 |  18,694,685 |

In the Annual Audit Report for CY 2009, an issue on the non-adjustment of inventory valuation for twenty-two (22) years was raised to emphasize the severity of Management’s deviation from established accounting standards. It has been previously agreed upon during prior years’ exit conferences that an independent third party appraiser be commissioned by Management to evaluate and appraise the Corporation’s aircraft parts inventory for the purpose of establishing a well-founded basis for the valuation of said inventory. Regrettably, this inventory valuation concern has not been fully addressed in the previous years up to the current CY 2015.

One of the concerns brought up by Management in a previous exit conference was the steep cost of such evaluation by an independent appraisal company in order to correct an accounting error which will not result into a tangible benefit in terms of revenue stream. While we take cognizance of Management’s concern on the costly fees of an independent third party appraiser, we stand by our position that this accounting mistreatment must not be perpetually carried in the books of accounts.

We recommended that PADC explore other feasible means to address this issue such as the possibility of obtaining the expertise of private aircraft technical individuals that may be competent to perform an appraisal of said inventory.

Management agreed to have the inventories classified as unserviceable to be evaluated by its own engineers and technicians and to make recommendations to the PADC Board on how to deal or dispose of those inventories that will little by little cleanse the inventory record and correct the amount reflected in the books. Likewise, Management committed to reconcile the inventory report with that recorded in the books and eventually take up the necessary adjustments.

1. **PADC has yet to remit to the National Government (NG) P6.840 million dividends due on past and current years’ earnings as required by RA 7656.**

(This is a reiteration of audit observations previously raised in the Annual Audit Reports for CYs 2011 and 2012.)

Section 3 of RA 7656, the “Act Requiring Government-Owned and/or Controlled Corporations to Declare Dividends, Under Certain Conditions to the National Government, and For Other Purposes”, requires that all government-owned or controlled corporations declare and remit at least fifty percent (50%) of their annual net earnings as cash, stock or property dividends to the National Government.

Our examination of the Dividends Payable to NG account disclosed that P4.418 million and P2.422 million representing dividends due on prior years’ and the current year’s earnings, respectively, have remained unremitted to date. Details of the outstanding dividend liability totaling P6.840 million is presented below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Calendar Year | Net Income | Should Be Remitted | Remitted | Balance |
| 2011 | 4,398,623 | 2,199,312 | 2,000,000 | 199,312 |
| 2012 | 6,482,088 | 3,241,044 | 3,000,000 | 241,044 |
| 2013 | 3,971,710 | 1,985,855 | 1,985,855 | 0 |
| 2014 | 7,955,306 | 3,977,653 | 0 | 3,977,653 |
| 2015 | 4,843,990 | 2,421,995 | 0 | 2,421,995 |
| Total | 27,651,717 | 13,825,859 | 6,985,855 | **6,840,004** |

We recommended that Management strictly comply with the provisions of RA 7656.

Management submitted to the COA audit team a copy of their letter dated April 5, 2016 addressed to the Secretary of Department of Finance (DOF) duly received by the DOF on April 26, 2016 requesting that PADC be granted temporary relief from the provision of RA 7656 requiring GOCCs to remit at least 50 per cent of annual net earnings to the National Government.

1. **Accrual in the books and payment of liabilities to the Commission on Audit (COA) and the Office of the Government Corporate Counsel (OGCC) representing assessments for cost of audit and legal services of P33.344 million and P2.384 million respectively, are not updated.**

During our audits of CYs 2013 and 2014, we reported that, out of the P11.852 million recorded COA assessments, only P2.400 million was paid, and that only P1.056 million out of P3.440 million recorded OGCC assessments has been settled. Further, it was stressed that no accruals for COA cost of audit services were taken up in the books for the period 2007 to 2013.

Balances as of December 31, 2015 remained virtually unchanged as no further accruals were taken up nor payments made to COA and the OGCC as recommended last year. However, updated information as of May 31, 2015 from COA’s Planning, Financial and Management Sector (PFMS) showed that the Corporation’s actual liability for cost of audit services amounted to P33.344 million.

Details of the liabilities to COA and OGCC are as follows:

 **COA**

|  |  |  |  |
| --- | --- | --- | --- |
| Year Assessed | Assessed CostOf Audit | Payments | Balance |
| 1990 | 318,313.00 | 0.00 | 318,313.00 |
| 1991 | 222,816.00 | 0.00 | 222,816.00 |
| 1992 | 1,135,594.00 | 0.00 | 1,135,594.00 |
| 1994 | 435,311.00 | 0.00 | 435,311.00 |
| 1995 | 534,519.00 | 0.00 | 534,519.00 |
| 1996 | 585,885.00 | 0.00 | 585,885.00 |
| 1997 | 871,741.00 | 300,000.00 | 571,741.00 |
| 1998 | 907,349.00 | 0.00 | 907,349.00 |
| 1999 | 1,005,580.00 | 0.00 | 1,005,580.00 |
| 2000 | 1,033,363.00 | 0.00 | 1,033,363.00 |
| 2001 | 1,339,699.00 | 0.00 | 1,339,699.00 |
| 2002 | 1,598,518.00 | 0.00 | 1,598,518.00 |
| 2003 | 1,596,126.00 | 0.00 | 1,596,126.00 |
| 2004 | 1,608,262.00 | 0.00 | 1,608,262.00 |
| 2005 | 1,496,663.00 | 0.00 | 1,496,663.00 |
| 2006 | 1,540,248.00 | 800,000.00 | 740,248.00 |
| 2007 | 1,568,303.00 | 0.00 | 1,568,303.00 |
| 2008 | 1,758,610.00 | 0.00 | 1,758,610.00 |
| 2009 | 1,545,466.00 | 0.00 | 1,545,466.00 |
| 2010 | 2,069,489.00 | 1,000,000.00 | 1,069,489.00 |
| 2011 | 2,455,240.00 | 0.00 | 2,455,240.00 |
| 2012 | 2,786,615.00 | 600,000.00 | 2,186,615.00 |
| 2013 | 2,806,675.00 | 0.00 | 2,806,675.00 |
| 2014 | 2,814,931.00 | 0.00 | 2,814,931.00 |
| 2015 | 2,008,942.00 |  | 2,008,942.00 |
| Totals | **36,044,258.00** | **2,700,000.00** | **33,344,258.00** |

 **OGCC**

|  |  |
| --- | --- |
| Beg. Balance, Jan.1 2004 | 2,525,000 |
| Accruals (2005-2007) | 625,000 |
| Accruals (2007-2013) | 290,000 |
| Payments(2006-2013) | (1,056,500) |
| Ending Balance, 12/31/2013 | **2,383,500** |

We recommended that Management:

1. Validate the COA PFMS cost of audit summary to determine if there are any unrecorded payments made by PADC or any other inconsistencies therein so that the amounts can be reconciled;
2. Recognize in the books of accounts the accrued cost of audit and legal services, and
3. Make periodic payments to the COA and OGCC.

Management replied that they acknowledge PADC’s liabilities to the COA and OGCC and will remit P2 million upon approval of the PADC COB.

1. **The CY 2015 Corporate Operating Budget (COB) of the Corporation do not bear the requisite approval of the Department of Budget and Management (DBM) as required by Executive Order No. 518 thus rendering all PADC spending for the year on unstable foothold.**

Section 6 of Executive Order No. 518 dated January 23. 1979, otherwise known as the “Government Corporate Budget Executive Order of 1978”, requires government-owned or controlled corporations to prepare an operating budget prior to the beginning of the year and have it recommended by its Governing Board for consideration and approval by the President/Prime Minister (presently delegated to the Department of Budget and Management).

Further, Section 15 of said Order provides that “No government-owned or controlled corporation shall incur obligations or make payments for current operating or capital expenditures after the beginning of each calendar year without a budget as approved under this Order.”

Our review of the Corporation’s budgetary and other fiscal transactions disclosed that its CY 2015 COB was not approved by the DBM. Upon inquiry from Management, it was learned that the reason for the lack of approval was because the COB was submitted to the DBM only on December 4, 2015, or about three weeks before the end of the fiscal year. The delay was due to the difficulty of mustering the required quorum for the members of the PADC Board to deliberate and approve the proposed 2015 budget. Earlier, board meetings were held during said year but the resolution and approval of the budget was not obtained. It was only in the first week of December 2015 that the majority number of board directors’ signatures was obtained to pass the 2015 budget.

We reiterate our previous audit recommendation that Management exert all efforts to promptly obtain the required board approval for the Corporation’s COB in order to comply with Executive Order No. 518.

Management replied that they will conduct constant follow-ups with the DBM for the approval of their 2015 COB.

1. **Summary of Total Suspensions, Disallowances and Charges**

For CY 2015 and 2014, the unsettled Suspension, Disallowances and Charges are as follows:

 2015 2014

|  |  |  |  |
| --- | --- | --- | --- |
|  Suspension | P | 0 | 0 |
|  Disallowances |  | 7,430,887.04 | 7,520,137.68 |
|  Charges |  | 9,259,741.45 | 9,259,741.45 |
|  | P | 16,690,628.49 | 16,779,879.13 |

1. **Other Matters**

 **Compliance with Republic Act (RA) 656 and 8291**

 PADC has insured its hangars and motor vehicles with GSIS pursuant to RA 656 as amended by Presidential Decree No. 245. A total of P541,553 has been paid as insurance premiums in 2015.

 PADC has been consistently deducting GSIS premiums from the salaries of its officers and employees and remitting the State Insurance Fund (SIF) and Employees Compensation Insurance Fund (ECIF) premiums to the GSIS in accordance with RA 8291. A total of P3.162 million was remitted in 2015.