# AUDIT OBSERVATIONS AND RECOMMENDATIONS

**1. The Corporation has not been able to generate operating revenue from its core business mandate for the past five consecutive years thereby indicating an immediate need to perform a comprehensive evaluation of its structure, policies and business processes to determine its sustainability as a going concern.**

Presidential Decree No. 286 provides for the three principal business mandates of the Corporation. At present, PADC has focused solely on its second corporate fiat which is the “*development of local capabilities in the maintenance, repair/overhaul, and modification of aerospace and associated flight and ground equipment and components thereof in order to provide technical services and overhaul support to government agencies owning aerospace equipment, the Philippine Air Force, the national airline, foreign airline companies, foreign air forces and to the aviation industry in general.”*

Lifted from the Corporation’s account ledgers and presented in tabular form are figures pertaining to gross operating revenues and direct operating costs for the past five years (2012-2016) resulting from the exercise of its business mandate as quoted above, to wit:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | 2016 | 2015 | 2014 | 2013 | 2012 |
| Sales Income(Labor & Overhead |  |  |  |  |  |
| Sales Revenue L&O-Military | 0 |  3,000 |  173,600 | 1,051,981 | 2,031,846 |
| Sales Revenue L&O-Non-Military | 1,127,186 |  909,567 | 1,334,680 | 1,852,291 | 4,055,347 |
| L&O (VAT Exempt) |  629,083 |  21,600 | 0 | 0 | 0 |
| L&O (VAT Zero) | 0 |  299,122 |  770,403 | 851,938 | 0 |
| Total L&O Sales | 1,756,269 | 1,233,289 | 2,278,683 | 3,756,210 | 6,087,193 |
|  |  |  |  |  |  |
| Cost of Sales (Labor & Overhead) |  |  |  |  |  |
| C/S L&O -Military | 0 | 0 |  295,000 | 0 | 1,661,326 |
| C/S-L&O-Non-Military  | 10,699,198 | 9,699,612 | 12,803,754 | 10,456,117 | 12,979,100 |
| Total L&O Cost | 10,699,198 | 9,699,612 | 13,098,754 | 10,456,117 | 14,640,426 |
| Deficit  | (8,942,929) | (8,466,323) | (10,820,071) | (6,699,907) | (8,553,233) |
| Cost over Sales (%) | 609 % | 686 % | 575 % | 278 % | 241 % |

Clearly, PADC’s fiscal data portray a pattern of operational deficits totaling about P43.480 million for the past five years. As could be gleaned from the table, cost of sales exceeded revenues from a range of 241 per cent to as much as 686 per cent during said period. While final income figures remain positive from 2012 to 2016, it is apparent that the Corporation has stayed afloat due to proceeds from rent, interest and miscellaneous revenues which are not from its core business mandate but are merely supplementary in nature.

Certainly, this situation illustrates a serious concern that needs to be urgently addressed if the Corporation aspires to survive as a going concern that is capable of performing its business mandate.

We recommended that PADC’s governing body and corporate management perform a comprehensive review of the Corporation’s structure, policies and business processes to promptly address the challenging state of affairs of the Corporation.

Management takes exception to our observation that the situation is indicative of serious problems in the Corporation’s structure, policies and business processes. While the operating deficit has ensued for the past five consecutive years, Management believes that an aggressive and well-planned marketing strategy will lure prospective clients both from the private sector and government entities such as the Philippine Air Force. The Corporation continues to confer with prospective clients and formulate strategies to update its capabilities in anticipation of future business opportunities.

We requested that Management furnish the team with copies of its marketing strategies and other sales promotional activities for future reference in audit.

**2. Failure of the Corporation to renew its Bureau of Customs (BOC) Importation License in a timely manner resulted in the incurrence of unnecessary costs totaling P60,000 for the release of aircraft parts from the BOC warehouse.**

Our audit of expenses for 2016 disclosed the payment of P99,477 (Disbursement Voucher No. 01-16-07-017) to 88 Sunfreight Express Corporation, a customs brokerage firm, for services rendered for ex-work/airfreight, customs facilitation, processing and brokerage for the release of imported aircraft parts. Among the supporting documents for said payment was Statement of Account No. 1844 dated June 30, 2016 stating that, of the P91,875 being billed, P60,000 pertained to “customs facilitation/non-import license”, a charge that supposedly could have been avoided had PADC itself transacted with the BOC. However, since the Corporation’s import license at that time was expired, it had to secure the services of 88 Sunfreight Express Corporation to obtain the release of the imported aircraft parts, thereby incurring additional unnecessary costs.

Section 4.1 of COA Circular No. 2012-003 dated October 29, 2012 defines unnecessary expenses as expenditures which could not pass the test of prudence thereby denoting non-responsiveness to the exigencies of the service.

It appears that there was negligence on the part of Management to file for the timely renewal of its import license which is essential for PADC to be able to secure the release of imported aircraft parts it had obtained from sources outside of the country. This capability is vital for the Corporation to fulfill its contract commitments to its customers.

We recommended that Management conduct an inquiry into the cause of the Corporation’s failure to renew its import license in order to pinpoint responsibility therefore and to avoid the recurrence of the situation in the future.

According to Management, the reason for the delay in the renewal of its importation license was due to the misperception that only the agency head can be designated as the Corporation’s official representative to the BOC. The President/CEO proposed that a regular permanent employee be named in his stead in order to avoid a situation wherein they will have to report a change in their representative should he later be replaced. Unfortunately, it took sometime before it was finally ascertained from the BOC that an officer other than the agency head may be designated as representative for the importation license. Pending resolution of the issue, the Corporation had to obtain the release of its imported aircraft spare parts, thus, had to avail of the services of 88 Sunfreight Express Corporation to avoid additional charges for the storage of said spare parts.

**3. The continued custody at the Toyota Service Center (Toyota Roxas Blvd.) of the official service vehicle assigned to the PADC President and Chief Executive Officer (CEO) has deprived the Corporation of the asset’s beneficial use and may unnecessarily result in additional charges for its storage and safekeeping**.

Our review of the inventory of official vehicles of the Corporation back in July 2016 disclosed that one (1) unit Toyota Camry bearing government plate number SGY-711 owned by and registered under the name of PADC and presently assigned to the Office of the President and CEO, had been consigned for repair at the Toyota Service Center located at Roxas Boulevard in Pasay City since January 2016.

Initial information we gathered was that repair services on the car had been completed in March or April 2016; but the official vehicle, as of our last confirmation on December 21, 2016, continues to remain at the Toyota Service Center.

We call Management’s attention on this concern for two reasons, namely:

a) Accountability for the government asset – pertinent provisions of PD 1445, otherwise known as the “Government Auditing Code of the Philippines”, set the rules on responsibility and accountability for government property. Government personnel entrusted with government funds or property shall be directly responsible therefore and loss of damage thereto shall be their personal liability.

b) Possible incurrence of unnecessary expenditures for the continued storage/custody of the official vehicle at the Toyota Service Center.

According to Management, the Toyota Camry continues to be in the custody of the Toyota Service Center because they refuse to pay for the repairs since they only requested for a cost estimate and did not give their consent to proceed with the recommended work order. Management claims that the Service Center could not present a written document to prove that a PADC employee or representative authorized them to proceed with the repair job.

We recommended that Management make a formal written demand for the return of the car and to consider consultations with legal counsel to determine the best course of action regarding the disagreement with Toyota Service Center.

*(The succeeding four observations are reiterations of previous years’ with corresponding adjustments made in the numerical data as appropriate.)*

**4. The aircraft parts inventory account continues to be carried in the books of accounts with insufficient allowance for obsolescence thereby overstating the reported net realizable value and understating expenses for 2016 by P17.355 million.**

Philippine Accounting Standard (PAS) 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.

In our 2015 audit report, we quoted figures from the Corporation’s books of accounts which show that the allowance for obsolescence for unserviceable and condemned aircraft parts inventory is insufficient by P17.355 million. It was recommended that Management exert efforts to have its Aircraft Parts Inventory properly appraised by independent Appraisers, not necessarily corporations, or partnerships, but individuals with the capability and knowledge who can satisfactorily render the services needed. This was suggested in view of Management’s notion that it is costly to hire an independent appraiser in order to correct an accounting error which will not result into any tangible benefit in terms of revenue stream. However, we stood by our position that an accounting mistreatment must not be perpetually carried in the books of accounts.

Our examination of the inventory account disclosed that appropriate adjustments have not been made to increase the balance of the allowance for inventory obsolescence account to present the aircraft parts inventory account at its net realizable value (NRV).

We reiterated our previous recommendation that Management initiate the appraisal of its aircraft parts inventory and to adjust the allowance for obsolescence account to reflect the NRV of said inventory account.

**5. The recording of accruals and the payment of liabilities to COA and OGCC representing assessments for cost of audit and legal services of P35.771 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 had been paid, and that out of the P3.440 million recorded OGCC assessments, only P1.056 million had been settled. Further, we emphasized 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, 2016 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 July 31, 2016 from COA’s Planning, Financial and Management Sector (PFMS) showed that the Corporation’s actual liability for cost of audit services amounted to P35.771 million. Details are presented on the following page.

 **COA**

|  |  |  |  |
| --- | --- | --- | --- |
| Year Assessed | Assessed CostOf Audit | Payments | Balance |
| 1990 | 318,313 | 0 | 318,313 |
| 1991 | 222,816 | 0 | 222,816 |
| 1992 | 1,135,594 | 0 | 1,135,594 |
| 1994 | 435,311 | 0 | 435,311 |
| 1995 | 534,519 | 0 | 534,519 |
| 1996 | 585,885 | 0 | 585,885 |
| 1997 | 871,741 | 300,000 | 571,741 |
| 1998 | 907,349 | 0 | 907,349 |
| 1999 | 1,005,580 | 0 | 1,005,580 |
| 2000 | 1,033,363 | 0 | 1,033,363 |
| 2001 | 1,339,699 | 0 | 1,339,699 |
| 2002 | 1,598,518 | 0 | 1,598,518 |
| 2003 | 1,596,126 | 0 | 1,596,126 |
| 2004 | 1,608,262 | 0 | 1,608,262 |
| 2005 | 1,496,663 | 0 | 1,496,663 |
| 2006 | 1,540,248 | 800,000 | 740,248 |
| 2007 | 1,568,303 | 0 | 1,568,303 |
| 2008 | 1,758,610 | 0 | 1,758,610 |
| 2009 | 1,545,466 | 0 | 1,545,466 |
| 2010 | 2,069,489 | 1,000,000 | 1,069,489 |
| 2011 | 2,455,240 | 0 | 2,455,240 |
| 2012 | 2,786,615 | 600,000 | 2,186,615 |
| 2013 | 2,806,675 | 0 | 2,806,675 |
| 2014 | 2,814,931 | 0 | 2,814,931 |
| 2015 | 2,008,942 | 0 | 2,008,942 |
| 2016 | 2,426,538 | 0 | 2,426,538 |
| Totals | **38,470,796** | **2,700,000** | **35,770,796** |

 **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 COA and OGCC.

**6. The Corporation has yet to remit to the National Government (NG) about P11.049 million in dividends for past and current years’ earnings as required by Republic Act No. 7656.**

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.

We have noted that the Corporation has not remitted to the NG dividends pertaining to net income for the following years:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Calendar Year | Net Income | Dividends Due | Year Remitted | Remitted Amount | Balance |
| 2011 | 4,358,396 | 2,179,198 | 2013 | 2,000,000 | 179,198 |
| 2012 | 6,482,088 | 3,241,044 | 2014 | 3,000,000 | 241,044 |
| 2013 | 3,971,710 | 1,985,855 | 2015 | 1,985,855 | 0 |
| 2014 | 7,955,306 | 3,977,653 | n/a | 0 | 3,977,653 |
| 2015 | 4,843,990 | 2,421,995 | n/a | 0 | 2,421,995 |
| 2016 | 8,459,326 | 4,229,663 | n/a | 0 | 4,229,663 |
| Total | 36,070,816 | 18,035,408 |  | 6,985,855 | **11,049,553** |

Of the total dividends due as of December 31, 2016 of P11,049,553, only the amount of P3,615,338 was set up in the books as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Amount Accrued | Amount Paid | Balance |
| CY 2013 | 2,000,000 | 2,000,000 | 0 |
| CY 2014 | 3,000,000 | 3,000,000 | 0 |
| CY 2015 | 3,000,000 | 1,985,855 | 1,014,145 |
| Balance 12-31-15 | 8,000,000 | 6,985,855 | 1,014,145 |
| CY 2016 | 2,601,193 | 0 | 2,601,193 |
| Balance 12-31-16 | 10,601,193 | 6,985,855 | 3,615,338 |

In the immediate past year, Management submitted to the 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. Said letter has not been favored with a reply.

We reiterated our recommendation that Management strictly comply with the provisions of RA 7656.

**7. The Corporation’s CY 2016 Corporate Operating Budget (COB) does not bear the requisite approval of the Department of Budget and Management (DBM) as of December 31, 2016 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 2016 COB was not approved by the DBM as of December 31, 2016. Upon inquiry from Management, we were informed that the reason for the lack of approval was due to the difficulty of mustering the required quorum for the members of the PADC Board to deliberate and approve the proposed 2016 budget.

We reiterated 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.

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

For CY 2016 and 2015, the unsettled Suspension, Disallowances and Charges are as follows:

|  |  |  |
| --- | --- | --- |
|  | 2016 | 2015 |
|  |  |  |
| Suspension | 0 | 0 |
| Disallowances | 7,430,887 | 7,430,887 |
| Charges | 9,259,741 | 9,259,741 |
| Total | 16,690,628 | 16,690,628 |

**9. 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 P231,465 has been paid for insurance premiums in 2016.

 PADC has consistently deducted GSIS premiums from the salaries of its officers and employees and remitted the same to the State Insurance Fund (SIF) and Employees Compensation Insurance Fund (ECIF) in accordance with RA 8291. Total remittances for CY 2016 amounted to P3.435 million.