OBSERVATIONS AND RECOMMENDATIONS

A. FINANCIAL AUDIT

1. The balance of the Spare Parts Inventory account of P54.754 million is unreliable due to the Management's non-assessment of the usability and commercial value of these inventories as of December 31, 2018. It was reported as early as 2015, that the account includes aircraft spare parts costing P40.919 million which are obsolete/unserviceable, however, the allowance for obsolescence of P23.564 million provided on the said inventories was short by P17.355 million and the amount of allowance remained the same as of December 31, 2018, overstating the inventories account.

1.1 Par. 9, Philippine Accounting Standard (PAS) No. 2 provides that inventories shall be measured at the lower of cost and net realizable value.

Par. 28, PAS No. 2 also provides that the practice of writing inventories down below cost to net realizable value is consistent with the view that assets should not be carried in excess of the amounts expected to be realized from their sale or use.

On the other hand, Par. 30, PAS No. 2 states that estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made, of the amount of inventories are expected to realize. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

1.2 As noted in the previous years' inventory reports, the Inventory Team of PADC in CY 2015 had identified and reported aircraft spare parts which are obsolete/unserviceable/condemned costing P40,918,983. To address the reported obsolete/unserviceable spare parts, the Audit Team recommended the adjustment of the Allowance for Obsolescence from P23,563,785 to P40,918,983 or an increase of P17,355,243, but the same was not implemented.

1.3 It was observed that the previous Management of PADC was not convinced on the report of their Inventory Team. From CY 2015 to CY 2017, the Audit Team has recommended the hiring of private appraisers or individuals who can satisfactorily render the services needed, but was negated by management for cost reasons. During the exit conference for the CY 2017 audit, Management committed to conduct the evaluation of the aircraft parts utilizing its own technical people, but the same did not materialize.

1.4 The figures on the next page are lifted from the subsidiary ledger of the Inventories – Spare Parts and Accessories account in CY 2018:

Particulars	Amount
Beginning Balance 12.31.17	75,793,435.60
Add: Purchases/additions	5,257,912.19
Total	81,051,347.79
Less: Issuances/withdrawals	2,733,822.74
Ending Balance 12.31.18	78,317,525.05
Less: Allowance for Obsolescence	23,563,740
Net Realizable Value	54,753,785.05

1.5 Verification disclosed that the recorded allowance for obsolescence amounting to P23,563,740 was set up more than 26 years ago.

1.6 In CY 2018, PADC applied with the Civil Aviation Authority of the Philippines (CAAP) for the renewal of their Aircraft Material Distribution Certificate (AMDC), hence, the latter conducted an inspection of the aircraft parts. Out of approximately 11,000 line items of Spare Parts Inventory, only 566 items were authorized/approved by CAAP for sale/distribution. Accordingly, most of the items in the inventory are no longer supported by documents/records and/or have no traceability (e.g. origin, supplier, year acquired/manufactured and etc) thus, could no longer be utilized or sold.

1.7 In view thereof, the representation of the balance of Spare Parts Inventory account amounting to P54,753,785 could not be relied.

1.8 ***We reiterated our recommendation that Management maximize its efforts and avail or explore all possible means to come–up with the updated inventory valuation and make the necessary adjustment to the inventory account.***

1.9 Management informed the Audit Team that with the transfer of PADC to DND, it has become imperative that the inventory count must be accurate and correct. Accordingly, an Inventory Team was reconstituted to determine the accuracy and correctness of the inventory as well as the condition of the spare parts whether serviceable, unserviceable/reparable or condemned. The team was given up to May 31, 2019 to complete the task.

2. The cost of audit services amounting to P32.567 million as of December 31, 2018 was not accrued in the books of PADC which is not in accordance with the provision of par. 27 of PAS No. 1, which requires that an entity shall prepare its financial statements using the accrual basis of accounting, resulting in the misstatement of the liability, expense and net income.

2.1 Based on the billing statement as of September 12, 2018 of the COA - Planning, Financial and Management Sector (PFMS), PADC's unsettled account for cost of audit services is P41,070,970 covering the period from CY 1990 to September 2018. Of this amount, P31.335 million represents the balance as of CY 2014 and P9.736 million is the cost of audit for CYs 2015 to 2018.

2.2 As reported in CY 2017, the Subsidiary Ledger (SL) for COA in PADC's books showed an account balance of P8,504,276 as of CY 2014 and there were no accruals made to the account from 2015 onwards. Thus, the account balance per COA-PFMS billing statement and PADC's books differ by P32,566,694 as shown below:

		Per PFMO Bill	Per PADC SL	Difference
Balance as of CY	2014	31,335,316	8,504,276	22,831,040
Cost of Audit CY	2015	2,008,942		2,008,942
	2016	2,426,538		2,426,538
	2017	2,204,316		2,204,316
	2018	3,095,858		3,095,858
		41,070,970	**8,504,276**	**32,566,694**

2.3 In addition, it was noted that PADC has unsettled assessment with the Office of the Government Corporate Counsel (OGCC) for legal fees amounting to P2,383,500 which had been outstanding since CY 2013, as shown below:

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**

2.4 There were no actions taken by Management in CY 2018 to address the issues and/or settle these accounts.

2.5 *We reiterated our recommendations that Management:*

a) direct the Accountant to reconcile PADC records with COA PFMS and recognize/record the accrued cost of audit as of the end of CY 2018;

b) make representation with COA and OGCC for possible installment payment of the outstanding balance, if one-time payment is not possible; and

c) make periodic payments thereafter.

2.6 Management noted the recommendations and had already directed the Accountant to reconcile the PADC records with the records of COA - PFMS and OGCC; likewise to accrue the cost of audit from CY 2015 to CY 2018 if COA assessment is found in order.

3. PADC has yet to declare dividends and remit to the National Government (NG) the amount of P23.890 million representing the dividends for past and current years' earnings as required under Republic Act No. 7656.

3.1 Section 3 of Republic Act No. 7656, also known as the "Act Requiring Government-Owned and/or Controlled Corporations to Declare Dividends, Under Certain Conditions to the National Government and for Other Purposes" provides that all government- owned and/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."

3.2 Our verification disclosed that PADC did not declare dividends for its net earnings for CY 2014 to CY 2018 and has an unremitted dividends to NG amounting to P23.890 million as of December 31, 2018. The details are as follows:

Calendar Year	Net Income	Dividends Due	Year Remitted	Amount Remitted	Total
2011	4,358,398	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
2017	8,649,617	4,324,809	n/a	0	4,324,809
2018	17,030,642	8,515,321	n/a	0	8,515,321
Per Audit	61,751,227	30,875,613		6,985,855	23,889,683

3.3 While the Corporation requested for temporary relief from the remittance of the 50 per cent of earnings as embodied in their letter to the Secretary of the Department of Finance (DOF) dated April 5, 2016, no reply from DOF has been received to date. PADC was not able to follow up the request for temporary relief after the change of administration in July 2016.

3.4 Records show that the dividends payable recorded in the books of PADC as of December 31, 2018 is only P15,374,474 compared with the balance per audit in the amount of P23,889,683 resulting to a difference of P8,515,209.

3.5 We recommended that Management:

a) propose to the Board of Directors the declaration of dividends for each year beginning 2014;

b) direct the Accountant to recognize/record the dividends payable of P8,515,209 once the dividends has been declared;

c) subsequent to a) and b), remit the dividends totaling P23,889,683 to the NG.

3.6 Management agreed with the recommendations, but they plan to reiterate their previous letter to the Secretary of Finance seeking temporary relief with regard to the remittance of dividends to the NG, as required in RA 7656.

B. COMPLIANCE AUDIT

4. PADC is no longer performing its core mandate, and had incurred financial operational losses totaling P177.904 million for the past six years (CYs 2013-2018), which warrant a comprehensive review of its structure, policies, financial capability and business market to determine the sustainability and economic viability of its continued existence.

4.1 PADC was created in 1973, purposely to develop and maximize the country's aviation and aerospace industry that will contribute to national security and the performance of other government functions. The goal was to establish a modernized and reliable technical repair and maintenance support system and a developed aircraft assembly and manufacturing industry, that will meet the needs of the aviation industry, both private and government, particularly the Armed Forces of the Philippines. The principal mandate of PADC as provided in Section 1 of PD 286 as amended by Section 2 of PD 696 dated May 9, 1975 are:

- *The design, assembly, manufacture, and sale of all forms of aircraft and aviation/aerospace devices, equipment or contraptions, and studies or researches for innovations and improvements thereon.*

- *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.*

- *The operation and provision of air transport services, whether for cargo or passengers on a scheduled, non-scheduled, or charter basis on domestic and/or international scale.*

4.2 Interview with concerned PADC personnel disclosed that the Corporation was able to perform its core mandate, particularly in the 80's and 90's. PADC had various contracts with both private entities and the government, such as the major Commands of the AFP, specifically the Philippine Air Force. These contracts cover both delivery and repair/overhaul services of aircraft parts and components.

4.3 However, in the late 90's, the revenue/earnings of PADC declined over the years. In the CY 2017 audit, it was reported that PADC's operational losses for the past five consecutive years (CY 2013 – 2017) had amounted to P149.615 million. CY 2018 is no different as PADC's sales revenue totaled only to P5.918 million, with cost of sales and operating expenses of P34.207 million, resulting to operating losses of P28.289 million.

4.5 The Corporation's revenue for CY 2018 are as follows:

Client	Nature of Revenue	Amount
AMA Properties and Management	Sale of Aircraft parts	640,770.00
Philippine Navy	Cost of labor and materials for the repair of PN Islander contracted in CY 2015 delivered and completed in 2018	5,198,826.74
	Cost of labor for the repair of port tip tank of PN 320 in CY 2018	78,727.68
		5,918,324.42

4.6 PADC's continuous existence is sustained primarily by the rental income from the three hangars leased by Cebu Pacific and eight others. These hangars are located and installed in the properties of Manila International Airport Authority (MIAA) which are leased to PADC. Rental income from these properties in CY 2018 aggregated P43.448 million, which compensated PADC's current operational loss of P28.289 million, which resulted to positive net income for the Corporation.

4.7 The lease contract/memorandum of agreement on the said properties were executed by MIAA and PADC in CY 1977 with a total monthly rental rate of P8,122 or an annual rate of P97,472. Obviously, the purpose of the lease was in support of PADC's principal or core mandate.

4.8 Moreover, some of the factors contributing to the loss of PADC's revenue opportunities are the following:

a) Absence of Tax Clearance due to cases filed by BIR against the Corporation in CYs 2003 and 2004 which are still unsettled. Tax Clearance is a mandatory requirement of RA 9184 in public bidding, hence, PADC is barred from joining public biddings conducted by government agencies.

b) Expired Accreditation to Conduct Repair. PADC's accreditation expired in August 2018. Application for renewal was submitted to Civil Aviation Authority of the Philippines (CAAP) but was not acted upon due to lack of documents showing compliance with the required trainings of PADC's technical personnel and the non-calibration of PADC's equipment.

c) Poor facilities and no landline and internet connections. PADC's offices/rooms are in poor condition and do not portray a reputable business image to the Corporation. (landline and internet connections were made available only in February 2019)

d) Lack of service vehicles. Most of PADC's vehicles are unserviceable.

e) PADC was blacklisted by the Philippine Navy (PN) in CY 2018 for failure to deliver/comply with conditions of the contract entered by the parties in CY 2015.

f) The aviation schools which previously availed the services of PADC are now operating their own maintenance facilities.

4.9 With these in view, it is clear that PADC is no longer performing and carrying-out its principal/core mandate.

4.10 It is also worth-mentioning that the Manila Bulletin in its January 4, 2018 issue, reported that the abolition of PADC was already raised in one of the meetings of the Governance Commission for GOCCs (GCG), but one of its directors opposed the proposal and instead recommended for its revitalization.

4.11 *We recommended that Management:*

a) Perform a comprehensive review of the Corporation's structures, policies, business market and the viability of its continuous operation. In determining its viability and necessity, Management should assess, among others, the following: (a) current condition of the aviation industry; (b) PADC's existing facilities and its technical capability; (c) PADC's financial position; and (d) competitiveness with private suppliers/local representatives of foreign suppliers/distributors, in view of the open/free trade agreements of the Philippines with some partner/allied countries;

b) Submit the results of the review/assessment with corresponding recommendations to the Governing Board, for their appropriate action; and

c) Initiate immediate action to address the identified problems (e.g. absence of tax clearance, expired accreditation, poor facilities) while the review is on-going.

4.12 Management commented that:

a) the incumbent President and CEO had issued directives to the concerned officers/personnel to:

- Immediately propose an acceptable settlement of tax liabilities with the BIR to secure the tax clearance;

- Submit all the requirements to CAAP for the renewal of the Approved Maintenance Organization (AMO) Certificate. According to latest update, submissions have been completed and that the AMO Certificate will be released soon ;

- Look into the possibility of acquiring two (2) new vehicles to replace the old ones which are already beyond economical repair.

b) The blacklisting order of PN against PADC had been shelved and the former signified its intention for the latter to perform the IRAN (Inspection Repair As Necessary) of PN 311. Likewise, Memorandum of Agreement (MOA) has been signed with Philippine State College of Aeronautics (PHILSCA) for the maintenance of their aircraft which will resume immediately upon the renewal of PADC's AMO accreditation with CAAP;

c) The supervision of PADC had been transferred to the Department of National Defense (DND) effective March 15, 2019, thus, major developments are expected to happen considering the number of air assets maintained by the Armed Forces of the Philippines (AFP).

5. PADC was not able to implement its targeted GAD projects and activities, thus the identified GAD issues and concerns were not addressed, denying its women populace and other intended beneficiaries the advantages/ improvement that could have been attained/realized from such activities. Moreover, PADC did not comply with the minimum GAD fund allocation of at least five per cent of the Corporation's budget as mandated in the Magna Carta for Women which could have been mainstreamed in the plans and budget for its regular programs, activities and projects.

5.1 RA No. 9710, otherwise known as the Magna Carta for Women (MCW) is a comprehensive women's human rights law that seeks to eliminate all forms of discrimination on Filipino women. These discriminations include gender-based distinction, restrictions, exclusions and other similar acts that limit and impair the rights of women in the society.

5.2 As a strategy in its implementation and attaining its objective, the law requires all government agencies, including Government-Owned and Controlled Corporations (GOCCs) to adopt gender mainstreaming in their policies, programs activities and projects within the context of their mandates. Likewise, to ensure proper implementation and adequate funding, the agencies are required to formulate GAD Plan and Budget (GPB) and to allocate at least five per cent (5%) of their total annual Corporate Operating Budget (COB) to GAD.

5.3 For CY 2018, PADC allocated P1,850,000 for its GAD related activities. Based on the report submitted to the Audit Team, the following is the summary of the Corporation's GAD Plan, Budget and the corresponding accomplishments during the year:

Gender Issue	Planned/targeted Output	Actual Output	Amount of Budget	Amount Utilized
Inadequate knowledge and competence to mainstream GAD related concerns in the agency	GAD mainstream-ed in preparation for the Agenda setting of PADC	Conducted Se-minar Work-shop on Gen-der mainstrea-ming, Gender analysis, as preparatory	250,000.00	68,853.25

Gender Issue	Planned/targeted Output	Actual Output	Amount of Budget	Amount Utilized
		work for GAD Agenda setting		
Lack of capa-city/compe-tence to formulate policies on GAD	Focused compre-hension on GAD related laws, knowledge, attitu-de and skill for all fifty (50) PADC personnel super-vised by an accredited GAD lecturer	None	200,000.00	-0-
	Focused compre-hension on GAD Responsive plan-ning knowledge, attitude and skill for all fifty (50) PADC personnel supervised by an accredited GAD lecturer	None	300,000.00	
Lack of gender responsive facilities	Construction of one room with 36 lockers (24 for men and 12 for women)	None	300,000.00	-0-
	One (1) comfort room each, for men and women to be available in the 3rd quarter of 2018	None	500,000.00	-0-
Lack of GAD office dedica-ted for all GAD related PAPs	Refurbished GAD room in Hangar 3	None	300,000.00	-0-
			1,850,000.00	68,853.25

Percent of utilization over budget (.68853/1.850) = 3.72%

Percent of budget over COB (1.850/81.171) = 2.28%

5.4 While PADC has allocated the amount of P1.850 million for Gender and Development, there were no activities or projects implemented to achieve projected outputs.

5.5 Moreover, the amount of P1.850 million is equivalent only to 2.28 percent of PADC's CY 2018 operating budget of P81.171 million. The minimum GAD allocation should have been P4.058 million.

5.6 ***We recommended that Management comply with the pertinent provisions of RA 9710; likewise, properly monitor the implementation of target GAD activities identified in the GPB.***

5.7 Management commented that while PADC had indeed lined-up several activities for the year, all of which were budget driven, most had to be deferred for failure of the then PADC management to secure the approval of the Board of PADC's 2018 COB early enough. The COB was approved by the Board on October 31, 2018, leaving the employees with just sufficient time to hold the Seminar Workshop on Gender Mainstreaming, Gender Analysis as Preparatory Work for the GAD Agenda setting last December 17-18, 2018. Management assured the Team that PADC will engage in more GAD related activities and undertakings to improve the working condition and uplift the morale and welfare of PADC employees both male and female.

6. Compliance with Statutory Deductions on GSIS

For CY 2018, PADC withheld and remitted the amount of P1,279,953 for its employees' contributions to the GSIS and P1,706,604 representing the Government share pursuant to the Implementing Rules and Regulations of R. A. 8291, otherwise known as the GSIS Act of 1997.

7. Status of Audit Suspensions, Disallowances and Charges

As of December 31, 2018, total audit disallowances amounted to P7,372,528.48. Of this amount, P5,041,956.18 are currently under appeal. On the other hand, the balance of charges amounted to P9,259,741.45.