

A. COMMENTS AND OBSERVATIONS

1. **The accuracy of the year-end balances of the Merchandise inventory accounts for calendar years 2009 and 2008 in the amount of P63,871,905 and P101,492,325, respectively, were doubtful due to negative balances of some items in the amount of P10,271,330.**

- 1.1 In our audit of Inventory account for calendar years 2009 and 2008, we found that eight and 176 inventory items were with negative balances in the amount of P8,681 and P10,262,649, respectively. We were informed by the Corporate Accountant that analyses of the said items in order to determine the causes thereof and reconciliation with the items on hand are still to be made.
- 1.2 Further evaluation disclosed that the PITC Pharma, Inc. (PPI) is not using the Coding Scheme in recording inventory transactions. Coding Scheme is a unique alphanumeric code assigned to an inventory item to facilitate an efficient recording/posting of receipts and issuances of inventory items/medicines. The Company is presently using the Brand Names with Descriptions of the specific items as a basis of recording receipts and issuances of inventory items/medicines. This practice is prone to error because one or more items/products have the same and/or almost the same descriptions as shown in the following table:

Particulars	July 31, 2009 Ending Balance	August 1, 2009 Beginning Balance	Difference
Carbocisteine 100mg/5ml 60ml (Solmux)	0	20	(20)
Solmux Ped 100mg/5ml 60ml	20	0	20
Carbocisteine 60ml (Solmux)	46	338	(292)
Solmux Broncho 2mg/500mg 60ml	292	0	292

- 1.3 As presented above, Carbocisteine 100mg/5ml 60ml (Solmux) had a zero balance as of July 31, 2009. However, the quantity forwarded as beginning balance on August 1, 2009 was 20. Further verification revealed that the quantity forwarded was that of the Solmux Ped 100mg/5ml 60ml. Likewise, Carbocisteine 60ml (Solmux) with an ending balance as of July 31, 2009 of 46 registered a beginning balance on August 1, 2009 of 338 because the ending balance as of July 31, 2009 of the Solmux Broncho 2mg/500mg 60 ml of 292 were forwarded as beginning balance on August 1, 2009 of Carbocisteine 60 ml (Solmux).
- 1.4 The above condition resulted in incorrect balances of the Merchandise inventory account because in addition to the incorrect quantity posted to a certain inventory item, the difference in price of each item affected the total cost of the said inventory items.
- 1.5 **We recommended that Management cause the thorough review and evaluation/analysis of inventory with negative balances and effect the necessary corrections to reconcile with the inventory on hand as of cut-off date. We also recommended that the Coding Scheme in the receipts**

and issuances of all inventory items be adopted to facilitate the recording and to avoid further errors.

1.6 Management commented that efforts were exerted to address the negative balances as shown in the significant decrease of these negative balances. Likewise, Management commented that they would study the Coding Scheme and adopt the Scheme that best fits their operations.

2. Results of confirmation of Due to affiliates and Interest payable accounts showed significant variances, casting doubt on the accuracy of the account balances presented in the financial statements.

2.1 One of the assumptions in the preparation and presentation of the financial statements of an organization is Faithful Representation, which means that financial information must be reliable. To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent at the reporting date.

2.2 To determine the existence and accuracy of the balances of Due to affiliates and Interest payable, we sent confirmation letters on the balances of the said accounts as of December 31, 2009 and 2008.

2.3 The result of confirmation of Due to affiliates - National Development Company/PITC and Interest payable showed net variances in the amount of P31,561,518 and P12,235,113 for December 31, 2009 and 2008 balances, respectively, as follows:

	2009			2008		
	PER PPI	PER NDC/PITC	DIFFERENCE	PER PPI	PER NDC/PITC	DIFFERENCE
Due to PITC	P 22,780,440	P 24,025,636	(P 1,245,196)	P 21,001,924	P 25,943,790	(P 4,941,866)
Due to NDC	3,481,280	3,047,922	433,358	6,169,397	5,332,440	836,957
Interest Payable on Loans Payable of P185 million	55,500,000	23,126,644	32,373,356	39,466,667	23,126,645	16,340,022
Net Amount	P81,761,720	P50,200,202	P31,561,518	P66,637,988	P54,402,875	P12,235,113

2.4 In the audit of PPI's financial transactions and operations in calendar year 2007, various reconciling items were identified and adjustments were taken up in the books of accounts. However, the above noted differences were the remaining variances that still need to be reconciled.

2.5 Considering the significance of the above variances, the accuracy of the balances of the affected accounts as presented in the financial statements, are doubtful.

2.6 We recommended and Management agreed that continuous efforts be exerted to coordinate with NDC and PITC to reconcile the accounts and prepare the necessary adjusting entries.

2.7 Management commented that they had already identified the variance with NDC account and will prepare a memorandum entry for the adjustment, while they would exert their best effort to reconcile the intercompany accounts with PITC.

3. Results of confirmation of Accounts receivable - trade - Department of Health (DOH) and Accounts receivable - non trade - PITC showed material variances, casting doubt on the accuracy of the accounts balances presented in the financial statements.

3.1 To prove the accuracy of the balances of Accounts receivable - trade - DOH and Accounts receivable - non trade - PITC, we sent confirmation letters to DOH and PITC.

3.2 The result of confirmation from the DOH showed variances in the amount of P7,028,234 and P600,455 for December 31, 2009 and 2008 balances, respectively, as follows:

	As at December 31, 2009	As at December 31, 2008
Per PPI books	P 20,823,578	P 600,643
Per confirmation	P 13,795,344	188
Variance	P 7,028,234	P 600,455

3.3 Likewise, the result of confirmation from PITC showed variances in the amount of P6,327,723 and P 820,108 for December 31, 2009 and 2008 balances, respectively, as follows:

	As at December 31, 2009	As at December 31, 2008
Per PPI books	P 10,431,736	P 4,796,742
Per confirmation	16,759,459	3,976,634
Variance	(P 6,327,723)	P 820,108

3.4 The materiality of the above variances cast doubt on the accuracy of the balances of the Accounts receivable - trade - DOH and Accounts receivable - non trade - PITC as presented in the financial statements.

3.5 We learned that some of the causes of the variances were already identified during the audit of PPI's financial accounts and operations in calendar year 2007. This included, among others, the absence of Receiving Reports showing proof of receipts of stocks by PPI, and in some cases the unit cost billed by PITC was not the one used in the costing of stocks received by PPI. As of audit date, the accounting entries were not yet taken up to reconcile the balance of this account with that of the PITC books.

3.6 We recommended and Management agreed that continuous efforts be exerted to coordinate with the concerned officers of DOH and PITC to identify the causes of the variances and correspondingly prepare the necessary adjusting entries.

3.7 Management also commented that they had already identified the causes of the P600,655 variance from the Department of Health for calendar year 2008 and would continue to exert more efforts to reconcile these accounts.

4. The balance of the Loss on inventory obsolescence account for the years 2009 and 2008 were overstated by P2,746,217.52 and P279,649.30, respectively, due to double recording.

4.1 The PPI's policy on Inventory is to record as outright expense for the year the stock expiring on or before the year ends and charge against the inventory account.

4.2 Our review of transactions related to the loss on inventory obsolescence revealed that expired medicines already taken up under account Loss on inventory obsolescence prior to calendar years 2009 and 2008 were again included and recorded under the same account for the years 2009 and 2008, in the amount of P2,746,217.52 and P279,649.30, respectively, or with an aggregate amount of P3,025,866.82, with the following details:

	CY 2009	CY 2008	TOTAL
Per books	P 4,872,030.93	P 5,371,614.05	P 10,243,644.98
Per Audit	2,125,813.41	5,091,964.75	7,217,778.16
Amount for adjustment	P 2,746,217.52	P 279,649.30	P 3,025,866.82

4.3 The above conditions resulted in the understatement of Merchandise inventory and Retained earning accounts in the amount of P2,746,217.52 and P279,649.30 for the calendar years 2009 and 2008, respectively.

4.4 The above observations were discussed and confirmed by the concerned employee of the PITC Pharma.

4.5 We recommended that Management cause the recording of the necessary adjusting entries to correct/adjust the Loss on inventory obsolescence account for the years 2009 and 2008 in the amount of P2,746,217.52 and P279,649.30, respectively.

4.6 Management commented that they acknowledged the double recording of the loss on inventory obsolescence for the years ended December 31, 2008 and 2009. However, the set-up of the loss on inventory obsolescence was based on physical counts, thus, the error was corrected when the entry was made for the physical count of the Merchandise Inventory for the year ended December 31, 2010.

- 4.7 We acknowledged Management's comment that the error was corrected as of the end of December 2010. However, to present fairly the financial statements for calendar years 2009 and 2008, adjustments should still be effected for the said years.
- 5. PPI granted welfare assistance to its officers and employees in the total amount of P727,500 and P710,000 for calendar years 2009 and 2008, respectively, despite the losses incurred by the Company for the said years.**
- 5.1 Verification of Personal services - other bonuses and allowances and Miscellaneous expenses accounts disclosed that welfare assistance in the total amount of P727,500 and P710,000 were granted to PPI officers and employees for CY 2009 and 2008, respectively, despite its operating losses in the amount of P53,236,586 in 2009 and P84,969,549 in 2008. The granting of said welfare assistance was based only on Board Resolution No. 2007-12-08.
- 5.2 Since PPI is a self-sustaining Company, created as a vehicle for government intervention in making cheaper and quality medicines available and accessible to the public, the viability of the company is crucial for effective implementation of the program. Thus, it is prudent for PPI to limit the expenditures to those vital to the operations considering that the Company has not yet generated income.
- 5.3 We recommended that Management stop the granting of the welfare assistance to its officers and employees and limit expenses to those vital to the day-to-day operations of the Company.**
- 5.4 Management commented that PPI is a SEC registered government corporation that is not receiving any appropriation from the government. Likewise, it is not covered by the Salary Standardization Law and as a Corporation created under the Corporation Code, the compensation of the company's employees is set by the Board of Directors. Moreover, they pointed out that the welfare allowance was substantially reduced and no salary increases were granted because of the losses incurred by Management. However, Management committed to comply with the recommendation to stop the granting of this allowance effective immediately.
- 6. Management did not renew the agreements with its territorial distributors and failed to strictly implement its basic terms and conditions specifically on the issuance of post-dated checks to PPI which was one of the causes of non-collection of the accounts.**
- 6.1 PPI entered into an agreement with private agencies appointing them as territorial distributors for the re-selling and distribution and/or forwarding of PPI's pharmaceutical products to PPI customers. The distributors shall promote, resell and deliver the products to customers using the agreed delivery process, system and lead times per the detailed flow process and forwarding of PPI products for orders directly obtained by the latter. The parties agreed that

the distributors shall pay PPI post-dated checks for each order and the check must be dated not later than 90 days from receipt of delivery. Likewise, they agreed that the agreement shall be valid for a period of six months subject to renewal upon mutual agreement of the parties in writing and in accordance with existing laws.

- 6.2 Our audit showed that PPI did not compel the territorial distributors to issue post dated checks for each delivery made and no payments were made by said distributors on due date. This resulted in the accumulation of uncollected receivables as shown below:

Territorial Distributor	Receivable as at 12-31-09	Transaction Date
Alphamed PharmaCorporation	P 1,494,225.05	April 2007 - December 2008
Azolsa Enterprises	3,712,002.21	October 2007 – May 2008
Big AA Pharma Trading	116,250.71	July 2008
Bilmed Corporation	2,495,747.83	March 2007 - June 2007
Gerden	321,274.45	March 2007
J-Health Marketing	60,887.13	November 2007
Sabijon Pharmacy	81,546.31	April 2007 - April 2008
Jolimed Pharmacy	942,246.21	Nov 2007 - Jan 2008
Jho James Drugstore	342,458.54	July 2007
Total	P 9,566,638.44	

- 6.3 Except for Big AA Pharma Trading, Jolimed Pharmacy and Jho James Drugstore, the above accounts were already forwarded to PPI Legal Department for appropriate action.
- 6.4 We also noted that the territorial distributors agreements were not renewed despite PPI's continuous business transactions with them, contrary to No. 1 of Article XIV of the TDA which states that "(t)his agreement shall be valid for a period of six months subject to renewals upon mutual agreement of the parties in writing and in accordance with existing laws." The details of the Agreements are shown below:

Distributor	Date Expired
1. MRV Pharma Distributor (Biolink)	January 30, 2007
2. ALPHAMED Pharma Corporation	October 30, 2007
3. AZOLZA, Inc. (Sun Shaine Drugstore)	January 17, 2007
4. JOLIMED	January 17, 2007
5. BILMED Corporation	January 17, 2007
6. JHO JAMES Drugstore & Distriutor	January 30, 2007
7. GERDEN	January 17, 2007
8. International Medexchange Depot	January 24, 2007
9. J Health Marketing	November 8, 2007
10. Medshop Drug	January 30,2007

- 6.5. **We recommended that Management cause the renewal and strict implementation of the provisions of the Territorial Distribution Agreement specifically the issuance of post dated checks.**

6.5 Management informed us that as of date of writing this report, contracts with territorial distributors (TDs) were not renewed because of the failure of the TDs to fulfill their obligations to the Company. However, they were preparing the necessary guidelines to ensure strict compliance of the provisions of the Agreements in case the services of the TDs would be required in the future.