A. COMMENTS AND OBSERVATIONS

A.1 Audit Observations and Recommendations

1. Insufficient capital and continuous losses from start of operation in 2006 to the current period cast doubt on the viability of the Corporation to continue operations and carry out its mandated functions.

The table below showed the data on the results of operations and financial position of PITC Pharma, Inc. for the current period 2012.

	2012	Per cent	2011	Per cent	Increase (Decrease) Amount	Per cent
Results of operation:						
Sales	63,727,097	100.00	154,222,927	100.00	(90,495,830)	58.68
Cost of sales	51,658,700	81.06	114,298,745	74.11	(62,640,045)	54.80
Gross profit	12,068,397	18.94	39,924,182	25.89	(27,855,784)	69.77
Operating expenses	35,894,097	297.42	49,798,330	124.73	(13,904,233)	27.92
Net loss	(23,825,700)	197.42	(9,874,148)	24.73	13,951,552	141.29
Financial Position:						
Cash & Cash Equivalents	3,917,857	8.50	18,427,745	25.58	(14,509,888)	78.74
Accounts receivable						
Trade – net	23,792,587	51.62	34,927,506	48.48	(11,134,919)	31.88
Non - trade	5,056,662	10.97	4,473,529	6.21	583,133	13.04
Inventories – net						
Merchandise inventory – net	482,970	1.05	2,902,209	4.03	(2,419,239)	83.36
Supplies inventory	456,182	.99	582,421	.81	(126,239)	21.67
Prepaid expenses	9,299,200	20.17	6,638,080	9.21	2,661,120	40.09
Property, plant & Equip.- Net	3,088,172	6.70	4,090,840	5.68	(1,002,668)	24.51
Total assets	46,093,630	100.00	72,042,330	100.00	(25,948,700)	36.02
Total liabilities	358,201,029		343,669,255		14,531,775	4.23
SE(Capital deficiency)	(312,107,399)		(271,626,925)		40,480,474	14.90

1.1 Results of operation

a. PPI had unsatisfactory results of operation for the current period evidenced by heavy losses. The Net Loss of P23.826 million was P13.952 million or 141.29 per cent more than the loss of P9.874 million in 2011.

b. The Sales for the current period decreased drastically by 58.68 per cent compared to the previous year, or from P154.223 million in 2011 to only P63.727 million in

2012. The current year sales of P63.727 million was also far below the P90 million projected sales in the Corporate Operating Budget.

c. For 2012, the cost of sales reached 81.06 per cent of sales or higher than the 74.11 per cent ratio in 2011. The unfavorable increase in the ratio of cost of sales to sales consequently decreased gross profit to cover operating expenses.

d. Operating expenses, however, decreased by 27.92 per cent compared to the previous year.

1.2 Financial position

a. Total assets decreased by 36.02 per cent, from P72.042 million in 2011 to P46.093 million in 2012.

a.1. The 2012 Cash balance of P3.917 million, which was only 8.50 per cent of the total assets, disclosed a significant decrease of P14.510 million or 78.74 per cent from the 2011 balance of P18.427 million. The current cash position was very insufficient to meet the operational requirements of the Agency.

a.2. Accounts Receivable-Trade as of CY 2012 disclosed the following balances:

Particulars	2012	Per cent
Commercial Accounts	32,148,404	52.29
Government Accounts	29,333,600	47.71
Total	61,482,004	100.00
Less: Allowance for doubtful accounts	37,689,417	61.30
Accounts receivable - trade - net	23,792,587	38.70

a.2.1 The above data showed very poor collection efficiency on accounts receivable. Out of the total receivables of P61.482 million, 61.30 per cent or P37.689 million have been delinquent, doubtful of collection and have been provided with allowance for doubtful accounts, thus, resulting in material losses to the Agency.

a.2.2 The total commercial accounts of P32.148 million were provided with full allowance for bad debts. These accounts have been outstanding for more than three years, since they pertain to CY 2007 and 2008 transactions.

a.2.3 Of the government accounts of P29.334 million, only P23.593 million pertain to accounts for the current year. The amount of P5.741 million pertains to prior years' accounts which could not be collected, thus, the accounts were also provided with full allowance for bad debts.

a.2.4. While PPI sends collection letters to the debtor agencies, most of the collection letters did not reach the intended addressees and were returned to sender (RTS). Examination of collection letters showed that the addressees were not the specific or designated person in the agency, but the name of the Office. Thus, even if the letter reached the correct location, nobody accepted.

a.3 Net merchandise inventory amounted to only P482,970 (P514,086-P31,116) or 1.05 per cent of the total assets. With the very low inventory level, together with the lack of cash and working capital, PPI could not meet the requirements of its clients.

b. Total Liabilities increased by 4.23 per cent from P343.669 million to P358.201 million.

b.1 Of the total liabilities of P358.201 million, the amount of P295.522 million pertained to a four-year loan with the National Development Company, which matured in December 2009. No payment had been made on the principal of P185 million and accumulated interest of P110.522 million.

b.2 Of the 2011 P26.087 million Accounts Payable – Trade (Note 9), only P13.748 million was paid during the year 2012

b.3. Of the total purchases of P56.698 million medicines during the year, only P42.901 million was paid as of year-end.

c. As a result of heavy losses and increased liabilities, PPI's capital deficiency for 2012 increased further by P40.480 million or 14.90 per cent, that is from P271.626 million in 2011 to P312.107 million in 2012.(SCE)

d. The results of operation for a period of seven years or from start of operation in 2006 to the current period, as presented in the table, showed that PPI had been into a negative financial position and consistent losses. Total assets were constantly decreasing while liabilities were increasing.

	2012	2011	2010	2009	2008	2007	2006
Results of operation:							
Sales	63,727,097	154,222,927	121,567,626	159,610,598	123,652,119	260,773,147	29,831,926
Cost of sales	51,658,700	114,298,745	96,235,358	126,427,811	94,581,125	203,465,098	21,146,231
Gross profit	12,068,397	39,924,182	25,332,268	33,182,787	29,070,994	57,308,049	8,685,695
Operating expenses	35,894,097	49,798,330	86,872,418	81,619,391	111,068,273	98,526,883	40,960,276
Net income(loss)	(23,825,700)	(9,874,148)	(61,540,150)	(48,436,604)	(81,997,279)	(41,218,834)	(32,274,581)
Financial Position:							
Total assets	46,093,630	72,042,330	135,060,266	172,172,451	227,541,537	291,778,461	290,520,725
Total liabilities	358,201,029	343,669,255	359,753,961	338,258,757	345,191,239	327,430,884	284,954,314
Stockholders' Equity / (Capital deficiency)	(312,107,399)	(271,626,925)	(224,693,695)	(166,086,306)	(117,649,702)	(35,652,423)	5,566,411

e. As of December 31, 2012, the ratio of assets to liabilities disclosed that for every P7.77 liability, PPI has an asset of only P1.00 to meet the liability (Total liabilities/Total assets = P358,201,029/P46,093,630 = P7.77). The material deficiency in capital showed that PPI did not even have the equity to meet its maturing liabilities. The very poor liquidity ratios implied PPIs inability to settle its obligations. This would adversely affect PPI's relations not only with suppliers but to all creditors, including the NDC, its Parent company PITC and other concerned government Agencies.

1.3 With PPI's Financial Condition and Results of Operations, there was an uncertainty that PPI could continue its operations and carry out its mandated functions as stated in Note 1 of the Notes to Financial Statements.

1.4 In 2011, PPI stated their plans and programs in Note 18 of the Notes to Financial Statements to improve its financial position and performance. Management commented that the PPI Board of Directors, with the recent changes in its organization, had expressed its full support for the "rehabilitation" of PPI and had directed management to design a Business Plan that shall address the corporation's capital deficiency over a period of time while aligning its strategies and activities towards the attainment of PPI's vision and mission. The corporation had identified the following three main goals which would help PPI eradicate its capital deficiency over the next few years:

a. Improved financial performance by increasing sales while reducing administrative expenses and capital sourcing and loan restructuring

b. Quality and cheaper healthcare products and services through continued partnership with private companies for the supply of pharmaceutical products

c. Strengthened Organizational Capacity by instituting concrete improvements in the different stages of operations

1.5 As of year-end, however, these measures were not carried out. There was no improvement in the financial position, working capital condition or results of operation of PPI.

1.6 Accomplishment and/or performance reports to gauge Agency performance were not prepared by Management. In spite of the unfavorable results of operations, there was no requirement for submission of reports that could have provided information and enabled Management to evaluate causes of the weakening condition and initiate plans and programs to address the same.

1.7 **We reiterated our previous recommendations that Management:**

a. **Conduct an assessment of the conditions affecting the ability of PPI to continue as a going-concern entity and identify the uncertainties that beset the Corporation.**

b. **Require the preparation of accomplishment/performance reports from each department so that Management would be able to evaluate strengths and weaknesses of the Agency and initiate measures to improve financial condition and operational performance.**

c. **Establish business plans and strategies to address the uncertainties and identify areas in the operations for streamlining, to increase sales, reduce costs and minimize losses. Carry out the measures mentioned in no. 1.4 above.**

d. **Make representations with NDC, for rescheduling of loan repayment/ restructuring of loan and with PITC and other concerned government**

agencies for additional capital and/or subsidy, for PPI to continue its operations and carry out its mandated functions.

e. **Intensify collection and initiate more effective and efficient strategies to recover trade receivables which have been uncollected for a long period of time. If necessary, take legal action against the debtors.**

1.8 Management took cognizance of the observations.

a. Management admitted that PPI was not able to successfully carry out in 2012 the measures stated in the Notes to Financial Statements for 2011 by which PPI hopes to overturn the continuous losses suffered over the years.

b. However, as disclosed in Note No. 18 of the 2012 Notes to Financial Statements, there is renewed hope that with new leadership and a new business model, PPI will be able to turn-around the company and sustain its operations. PPI's sustainable competitive advantage is that it is the only pharmaceutical GOCC that aggregates all orders of medicines of public health facilities and government agencies in order to achieve competitive prices for quality medicines. Given this advantage, PPI leverages its strength towards servicing the medicine requirements of the public sector as well as the big private corporations and foundations, particularly the CSR programs on health.

c. PPI's 2013 1st quarter performance shows that it is headed in the right direction. The outlook for the rest of the year is positive.

d. PPI noted that Management has:

- Required the different departments to submit a Monthly Performance Report, from which the President and CEO culls his own Monthly Performance Report to the PPI Board of Directors.

- Written NDC requesting the restructuring of the loan that matured in 2009, with a rescheduling of the repayment period and the reduction of the present interest rate from 10 per cent to 5 per cent per annum.

e. Management is presently closely coordinating with the OGCC for adopting the best methods in the pursuit of collecting past due receivables. It is worthy to note that PPI's collection from its 2012 to 2013 sales for government accounts had tremendously improved to almost 100 per cent.

2. The Corporation was not able to plan or undertake Gender and Development activities mandated under DBM-NEDA-NCRFW Joint Circular No. 2004-1 because of the existing financial difficulty.

2.1 Audit showed that PPI did not have a Gender and Development (GAD) Plan nor did it have GAD activities. Although aware of its mandatory nature, PPI was not able to give priority on the program in view of the existing adverse financial condition.

2.2 **We recommended that Management:**

a. **Pursue implementation of the DBM-NEDA-NCRFW Joint Circular 2004-1.**

b. **Formulate a GAD Plan to address the gender issues of its female employees.**

c. **Set aside at least five per cent of the Corporate Operating Budget to implement the GAD Plan.**