

NOTES TO THE FINANCIAL STATEMENTS
(All amounts in Philippine Peso unless otherwise stated)

1. AGENCY BACKGROUND

Philippine Pharma Procurement, Inc. (PPPI) formerly known as PITC Pharma, Inc. (PPI), a subsidiary of the Philippine International Trading Corporation (PITC) and an affiliate of the National Development Company (NDC), is the only pharmaceutical government owned and controlled corporation (GOCC) tasked to provide low priced quality ensured medicines to the Filipino people.

PPPI was created to serve as the corporate vehicle that will implement the Half-Priced Medicines Program of the government.

PPPI is classified under the Human Development and Poverty Reduction Cluster by the Governance Commission for GOCCs (GCG). Its mandate is defined under the Implementing Rules and Regulations (IRR) of RA No. 9502, otherwise known as the Universally Accessible Cheaper and Quality Medicines Act of 2008, wherein PPPI has been given the following roles:

- a. Undertake direct importation for government agencies and offer the same facility to private parties

Chapter III, Rule 16, Section 1 of the IRR states that:

“Except for specific programs and instances allowed by the DOH, for purposes of ascertaining the best and most affordable prices and quality of drugs and medicines to be imported, all government agencies must centrally procure through PPI.”

- b. Establish a common facility for pooled procurement

Chapter XI, Rule 58 of the IRR states that:

“The PPI or its equivalent agency is authorized to establish a common facility for pooled procurement in compliance with RA 9184.”

In June 2010, the Government Procurement and Policy Board (GPPB) confirmed PPI as a servicing agency for government agencies under the alternative mode of procurement by agency-to-agency agreements. It further ruled that PPPI may also act as a procurement agent for government entities subject to Section 53.6 of the Revised IRR of RA No. 9184.

The License to Operate as a Drug Distributor/Importer/Wholesaler was initially granted to PPPI on October 16, 2006 while the present license is valid until October 16, 2019.

As of December 31, 2016, PPPI has a manpower complement of 48 regular and probationary employees.

The principal office address of the Company is at 2nd floor, NDC Building, 116 Tordesillas Street, Salcedo Village, Makati City.

2. REPORT ON OPERATIONS

PPPI's net sales for the year amounted to Php 154.31 million or 172 per cent higher than the target for the year of Php 89.62 million. However, this is only 16 per cent compared to total sales for the same period in 2015 of Php 941.258 million. The reduction in the sales target was mainly due to the change in the sales arrangement between the Department of Health (DOH) and PPPI from a supplier to a procurement outsourcing service provider.

While direct sales from the DOH was not projected in 2016 because the revenue was to come from service fees, additional orders of digital sphygmomanometers which could only be delivered during the 1st quarter of 2016 and deferred deliveries of oncology medicines for the Acute Lymphocytic Leukemia Medicines Access Program (ALLMAP) accounted for 64 per cent of the total sales for the year.

On the other hand, sales to local government units (LGUs) and other government agencies was accounted for by sales of generic medicines and vaccines, mainly influenza polyvalent and pneumococcal polyvalent vaccines which were supplied through the ordering agreement arrangement with suppliers. Sales under this customer classification only accounted for 36 per cent of the total sales for the year due to the limited number of medicines being offered.

PPPI projected to generate a service income of Php 62.131 million from the DOH in 2016. However, due to the policy of the DOH Secretary during the 1st half of the year to do an in-house procurement for all its medicine requirements, PPPI did not get any project from the DOH during the 1st semester. When the new DOH administration assumed in July 2016, most of the medicine requirements for the year were already bid out except for some procurement activities that had bid failures. In December 2016, DOH secured three procurement projects, namely the supply and delivery of medicines for the Childhood Cancer Medicines Access Program amounting to Php 29.764 million, Breast Cancer Medicines Access Program (BCMAP) amounting to Php 24.514 million and Kawasaki Disease Medicines Access Program amounting to Php 35.462 million. The service fee will be realized in 2017 when the procurement process would have been completed and the delivery effected.

PPPI has set two (2) performance measures under the Social Perspective of its 2016 Performance Scorecard, namely to generate sales from 50 per cent of the 25 PhilHealth-contracted hospitals for Z package and serve LGUs from 40 provinces through Procurement Service-Department of Budget and Management (PS-DBM) or direct sales. For the first performance measure, PPPI was able to achieve the target, generating sales from 16 out of the 25 PhilHealth Contracted hospitals or 64 per cent. For the second performance measure, PPPI was only able to cover 16 provinces.

PPPI continued to pursue its Memorandum of Understanding (MOU) with Bio Farma of Indonesia, a state-owned pharmaceutical company manufacturing vaccines and sera, some of which are WHO-prequalified and used for the World Health Organization (WHO) Expanded Program on Immunization (EPI). The intent of the partnership is for PPPI to

service the EPI vaccines requirement of the DOH with Bio Farma supplying the vaccines. A Supply Agreement between Bio Farma and PPPI shall be executed once the vaccines to be sourced under this agreement are identified.

In connection with the institutionalization of its Quality Management System (QMS) and to continually improve its internal processes, PPPI passed the surveillance audit conducted by TUV-SUD PSB Inc. on December 7, 2016. It has been re-certified in accordance to the requirements of International Standardization Organization (ISO) 9001:2008 for the same scope: Procurement, Sales, Supply and Delivery of Pharmaceutical Products.

2017 Direction

In line with the directive of President Rodrigo Roa Duterte to “revive the *Botika Ng Bayan*,” PPPI has submitted a proposal to the Philippine Amusement and Gaming Corporation (PAGCOR). The position of PPPI, which is similar to the view of the DOH, is to tap existing health facilities as *Botika Ng Bayan* outlets. In the various meetings regarding this directive, it was decided that the program shall be called “*PHA Medisina*.”

An Executive Order (EO) to be signed by the President was also drafted by PPPI and submitted to the Department of Trade and Industry (DTI) and DOH, for their review and comments. The EO designates PPPI to establish a Pooled Procurement Facility for Medicines and directs national government agencies, GOCCs and LGUs to procure from this facility.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Financial Statement Preparation

The financial statements are presented in Philippine peso, PPPI’s functional currency, and all values are rounded to the nearest peso, except when otherwise indicated.

The financial statements were prepared on a Going Concern basis.

b. Statement of Compliance

The accompanying financial statements were presented in conformity with the Generally Accepted Accounting Principles in the Philippines (GAAP) in the Philippines as set forth in the Philippine Financial Reporting Standards (PFRS).

c. Cash & Cash Equivalents

Cash includes cash on hand and in bank. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with maturity dates of three months or less from the date of acquisition.

d. Accounts Receivable – Trade

Trade receivables are recognized at their face value minus allowance for doubtful accounts.

The allowance for doubtful accounts is provided for identified potentially uncollectible receivables using the following estimates:

Accounts aged three years and above	=	100 per cent
Accounts aged two years	=	50 per cent
Other uncollectible accounts aged one year	=	25 per cent

e. Prepaid Expenses

Prepayments are amortized over the applicable period.

f. Inventories

Merchandise Inventory is valued at lower of cost and net realizable value. Cost is determined using the specific identification method.

Office supplies inventory are valued at cost.

The provision for inventory loss is based on the expiration dates of stocks counted during the year-end physical count. Stocks that are expired as of the end of the current year are considered outright expense and therefore, charged against the inventory account. A 50 per cent allowance is provided for medicines that will expire from January to June of the succeeding year and 25 per cent allowance for medicines that will expire from July to December of the same year.

g. Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets in accordance with COA Circular No. 2003-007. In the case of leasehold improvements, the assets are depreciated over the period of the lease or service life of the improvement, whichever comes first.

h. Trade and Other Payables

Accounts payable are recognized in the period when legally enforceable claim against the Company arises. The account is recognized initially at fair value and subsequently measured at amortized cost using the effective interest method less any settlement payments.

i. Revenue and Expense Recognition

Revenue is recognized to the extent that it is possible that the economic benefits will flow to the Company and the revenue can be reliably measured.

The company adopts the accrual method of accounting.

- i. In selling goods, revenue is recognized upon the transfer of significant risk and rewards of ownership of the goods to the customer. Revenue is not recognized to the extent where there are significant uncertainties regarding recovery of the consideration due, associated costs, or the possible return of goods.
- ii. When rendering services, revenue is recognized upon completion of services and has been accepted by the customers.

Interest income from deposits is presented at net of final withholding taxes.

4. CASH AND CASH EQUIVALENTS

The account is composed of the following:

	2016	2015
Cash on hand and in bank	5,026,735	53,798,792
Money market placements	89,739,393	5,027,287
Total	94,766,128	58,826,079

Cash on hand refers to undeposited collections of P143,031.

Cash in bank pertains to the peso current account with the Land Bank of the Philippines (LBP).

Money market placements pertain to the high yield peso savings account with LBP with an interest rate of 1 per cent for 30 and 60 days and 1.125 per cent for 90 days. These placements are funds held in trust for the DOH.

5. ACCOUNTS RECEIVABLE – TRADE

This account is categorized into the following:

	2016	2015
Department of Health	25,894,464	307,236,730
Private accounts	29,796,930	31,292,002
Other government accounts	5,362,528	12,083,250
	61,053,922	350,611,982
Less: Allowance for doubtful accounts	35,703,579	36,919,376
Total	25,350,343	313,692,606

6. ACCOUNTS RECEIVABLE – NON TRADE

This account is composed of the following:

	2016	2015
Due from Social Security System (SSS)	15,719	98,099
Due from officers and employees	120,343	82,169
Other receivables	3,535,575	3,021,512
	3,671,637	3,201,780
Less: Allowance for doubtful accounts	3,012,134	3,012,134
Total	659,503	189,646

Other receivables pertain mainly to merchandise inventory returned to suppliers and charges to suppliers for actual cost of warehouse fee, Food and Drug Administration (FDA) samples and printing of medicine boxes.

7. INVENTORIES – NET

This account is composed of the following:

	2016	2015
Merchandise inventory	871,577	3,200,524
Less: Allowance for loss on inventory obsolescence	18,441	63,571
Balance, December 31	853,136	3,136,953

Changes in allowance for inventory losses are as follows:

	2016	2015
Balance, January 1	63,571	72,811
Adjustment	(45,130)	(9,240)
Balance, December 31	18,441	63,571

8. PREPAID EXPENSES

This account consists of the following:

	2016	2015
Prepaid income tax carry over	18,760,040	15,685,127
Prepaid income tax - MCIT	2,277,635	1,937,028
Prepaid input tax carry over	10,115,107	318,430
Supplies inventory	61,216	25,314
Guaranty deposits	32,859	32,859

	2016	2015
Prepaid insurance	38,498	43,046
Others	134,686	159,973
Total	31,420,041	18,201,777

Prepaid income tax carry over pertains to the unused/unapplied certificate of withholding tax at source. This is the result when the creditable withholding tax is higher than the income tax payable.

Prepaid income tax – MCIT pertains to the unexpired portion of the excess minimum corporate income tax (MCIT) over the normal income tax.

Prepaid input tax carry over is the excess of input tax over output tax and the excess of creditable final withholding tax over the value added tax payable.

Guaranty deposits pertain to the deposit fees on the contract with Ricoh Philippines, Inc. for the photocopying services, and deposit with NDC for the use of an area at the ground floor of the building.

9. PROPERTY PLANT AND EQUIPMENT

This account consists of the following:

Particulars	Leasehold Improvements	Furniture and fixtures/library books	Communication Equipment	IT Equipment and Software	Office Equipment	Other Machineries and Equipment	Motor Vehicles	Total
<u>CY 2016</u>								
Costs								
January 1	2,374,501	1,317,887	297,889	4,951,818	160,875	129,003	1,800,000	11,031,973
Additions				31,250				31,250
Adjustment				(598,934)				(598,934)
December 31	2,374,501	1,317,887	297,889	4,384,134	160,875	129,003	1,800,000	10,464,289
<u>Accumulated Depreciation</u>								
January 1	2,137,051	928,252	124,062	3,618,739	135,975	44,491	540,000	7,528,570
Depreciation	0	118,128	26,810	247,189	3,777	23,220	324,000	743,124
Adjustment				(539,061)				(539,061)
December 31	2,137,051	1,046,380	150,872	3,326,867	139,752	67,711	864,000	7,732,633
Net Book Value								
December 31	237,450	271,507	147,017	1,057,267	21,123	61,292	936,000	2,731,656
<u>CY 2015</u>								
Net Book Value								
December 31	237,450	389,635	173,827	1,333,079	24,900	84,512	1,260,000	3,503,403

Leasehold improvements consist of the cost of the renovation of the rented office space at the 2nd floor of the NDC Building.

Adjustment to IT Equipment and Software pertains to the cost of unserviceable items which were reclassified to Other Assets account.

In CY 2014, PPPI acquired two motor vehicles through a Financial Lease Agreement with the DBP Leasing Corporation payable for a period of three years. The total of future minimum lease payments amounted to ₱205,451.

10. DEFERRED TAX

	Carrying Amount	Future Taxable Amount	Future Deductible Amount	Tax Base	Taxable Temporary Difference	Deductible Temporary Difference
Cash and cash equivalents	94,766,128			94,766,128		
Trade receivables	25,350,343		35,703,579	61,053,922		35,703,579 [1]
Other receivables	659,503		3,012,134	3,671,637		3,012,134 [1]
Prepaid expenses	31,420,041	(234,400)		31,185,641	234,400	[2]
Inventories	853,136		18,441	871,577		18,441 [3]
Property, plant and equipment	2,731,656			2,731,656		
Other non-current assets	59,873			59,873		
Total assets	155,840,680	(234,400)	38,734,154	194,340,434	234,400	38,734,154
Accounts payable	44,391,496			44,391,496		
Inter-Agency payables	99,232,314			99,232,314		
Other current liabilities	183,889,190			183,889,190		
Vacation and sick leave	2,421,970		(2,421,970)			2,421,970
Due to affiliates	21,045,654			21,045,654		
Loan payable	163,528,914			163,528,914		
Other non-current liabilities	5,451,748			5,451,748		
Total liabilities	519,961,286		(2,421,970)	517,539,316		2,421,970
Total stockholders' equity	37,500,000			37,500,000		
Total temporary difference					234,400	41,156,124
Deferred tax					30%	30%
Liability					(70,320)	
Asset						12,346,837
Beginning balances					(68,500)	12,741,083
Adjustments					(1,820)	(394,246)
Total charges from deferred income tax						(396,066)

[1] Allowance for doubtful accounts

[2] Prepayments

[3] Allowance for inventory obsolescence

11. OTHER NON-CURRENT ASSETS

Other assets represent the unserviceable IT Equipment and Software with a cost of ₱59,873.

12. ACCOUNTS PAYABLE

This account consists of:

	2016	2015
Accounts payable – trade	40,716,906	333,605,808
Accounts payable – non-trade	3,674,590	3,266,463
Total	44,391,496	336,872,271

Accounts payable – trade represents amount due to various suppliers for the procurement of merchandise for sale.

Accounts payable – non-trade are liabilities arising from various services such as security, janitorial, expenses for utility, communications and other expenses.

13. INTER-AGENCY PAYABLES

This account consists of:

	2016	2015
Due to DOH	1,618,428	1,618,428
Due to COA	7,540,357	5,387,008
Due to BIR	128,982	5,117,373
Due to SSS	105,129	115,033
Due to PAG-IBIG	70,050	82,330
Due to PHILHEALTH	21,975	23,600
Total	9,484,921	12,343,772

The account Due to DOH represents the unliquidated balance of the ₱50 million fund transfer intended for the “DOH ₱100” project pursuant to DOH Administrative Order No. 2008-0013, and covered by a Memorandum of Agreement (MOA) by and between DOH and PPPI. The amount is presented at net of the cost of stickers and packaging materials advanced by PPPI for the project.

The liability to the Bureau of Internal Revenue (BIR) includes income taxes and withholding taxes for filing and/or remittance in January of the following year.

14. OTHER CURRENT LIABILITIES

This account is broken down as follows:

	2016	2015
Current portion of loan payable (Note 15)	128,266,340	88,388,013
Customers’ deposit	89,739,393	0
Interest payable	50,742,570	30,260,941
Vacation and sick leave	2,421,970	2,475,197

	2016	2015
Due to officers & employees	2,341,364	1,424,310
Performance/bidders bond (Note 17)	507,777	19,788,596
Note payable	205,451	644,277
Due to other funds	173,000	173,000
Others	1,570,688	1,514,812
Total	275,968,553	144,669,146

Customers' Deposits represent the fund transfer from DOH to PPPI to cover the payment for the various medicines to be procured under the Agency Outsourcing Requests (AOR).

Interest payable represents accrued interest on the loans availed from NDC (Note 14). Vacation and Sick Leave payable pertain to the monetary value of the unused accumulated vacation and sick leave credit balances.

Note payable pertains to the net carrying amount of the account. In 2014, PPPI entered into a three-year lease agreement with DBP Leasing Corporation for the acquisition of two motor vehicles amounting to ₱1,800,000 payable in 36 monthly installments of ₱59,581.49. Residual value of the two vehicles amounted to ₱90,000 at the end of the lease term.

Due to Other Funds represent fund transfers made by IPVG/Apolloplus to finance importations of drugs and medicines using PPPI's import facility.

Other payables include trust liabilities arising from proceeds from the sale of bid documents, among others, and a fund entrusted by a supplier for the payment of advocacy expenses.

15. LOAN PAYABLE

This account pertains to the non-current portion of the restructured loan with NDC.

The NDC and PPPI entered into a Loan Restructuring Agreement effective June 30, 2013 with a new loan amount of ₱291,795,254.40, consisting of the outstanding principal and accrued interest thereon. The loan is payable every quarter for a period of eight years with a one-year grace period and bears an interest rate of seven per cent per annum, also payable every quarter.

16. DUE TO AFFILIATES

This account consists of:

	2016	2015
Due to PITC	7,761,650	9,141,575
Due to NDC	13,284,004	12,154,059
Total	21,045,654	21,295,634

The liability to PITC includes portion of cost of stocks transferred from PITC, trade returns accepted from previous PITC sales, and other direct expenses unpaid as of the end of the year.

The Due to NDC account represent liabilities accruing from the use of NDC facilities.

17. OTHER NON-CURRENT LIABILITIES

This account consists of the performance and bidders bond for completed projects covering the period 2009 to 2015 which are not yet returned to suppliers and bidders.

18. CAPITAL STOCK

PPPI has authorized capital stock of ₱100 million, divided into one million (1,000,000) common shares at a par value of ₱100 per share.

The Subscribed and Paid-in Capital of ₱37,500,000 consist of:

Investors		Amount
Philippine International Trading Corporation	60%	22,500,000
National Development Company	40%	15,000,000
Total	100%	37,500,000

19. SALES

Sales are broken down into the following categories of customers:

	2016	2015
Department of Health	116,692,492	906,905,928
Other Government Accounts	36,273,578	32,604,329
Private Accounts	1,344,386	1,747,997
Total	154,310,456	941,258,254

20. COST OF SALES

The Cost of sales is computed as follows:

	2016	2015
Beginning Inventory	3,136,953	4,284,897
Add: Purchases	135,573,926	890,072,077
Total Goods Available for Sale	138,710,879	894,356,974
Less: Ending Inventory	853,136	3,136,953
Cost of Sales	137,857,743	891,220,021

21. OPERATING EXPENSES

Operating expenses is classified into Selling and Distribution Expenses, and Administrative Expenses, detailed as follows:

	Selling and distribution expenses		Administrative Expenses	
	2016	2015	2016	2015
Personal services				
Salaries and wages	5,541,148	5,671,340	7,540,176	8,009,507
Other compensation	3,159,905	2,853,253	5,279,453	5,571,669
Personnel benefits contributions	357,584	387,263	461,827	493,478
Sub-total	9,058,637	8,911,856	13,281,456	14,074,654
Maintenance and other operating expenses				
Professional services	776,471	793,137	3,367,896	2,377,602
Loss on inventory obsolescence			93,258	
Taxes, insurance premiums & other fees	46,720	76,965	3,721,914	2,231,663
Advertising and marketing expense			116,800	247,110
Representation expenses	46,346	84,633	68,538	210,116
Bad Debts Expense				4,817,743
Training expense	16,900	1,000	49,503	205,921
Rent expense	15,905	22,443	2,710,004	3,069,383
Travelling expenses	139,227	281,230	7,554	14,423
Depreciation			743,125	743,285
Communication expense	213,395	229,865	577,917	563,046
Donations			1,431	
Utility expenses			635,368	1,106,768
Subscription	4,176	3,005	8,150	7,068
Supplies and materials expenses	50,871	54,133	242,643	422,867
Transportation and delivery expenses	790,018	932,678	1,785	
Repairs and maintenance	326	7,665	67,075	54,064
Membership dues and contributions			4,300	
Printing and binding expenses		357	13,122	4,582
Miscellaneous expenses		3,094	1,629,566	1,293,072
Bank Charges			950	
Sub-total	2,100,355	2,490,205	14,060,899	17,368,713
Total	11,158,992	11,402,061	27,342,355	31,443,367

22. OTHER INCOME (EXPENSES)

This account is broken down as follows:

	2016	2015
Financial charges	0	(1,850)
Interest income	66,153	98,816
Interest expense	(18,354,502)	(18,566,135)
Adjustment of allowance for inventory obsolescence	41,910	9,240
Miscellaneous income	535,742	3,532,665
Total	(17,710,697)	(14,927,264)

Miscellaneous income pertains to the liquidating damages paid by GB Distributors, Inc. and other miscellaneous receipts.

23. RELATED PARTY TRANSACTIONS

The Corporation's related party pertains to its parent corporation, the PITC and NDC.

As a key strategy to develop pharmaceutical program focusing on the expansion of Botika ng Bayan accredited retail outlets as well as to strengthen institutional linkages with key government agencies and LGUs, PITC and NDC have agreed to collaborate in the setting up of a corporate vehicle that shall exclusively pursue the government's pharmaceutical program under Executive Order No. 442 and likewise carry out the business of, among others, sourcing, selling, manufacturing and distributing low cost quality medicines.

As evidenced by the Shareholders Agreement, NDC and PITC agreed that the Shareholders shall subscribe to and fully pay the 37.50 per cent subscriptions in PPPI's authorized capital stock.

24. TAX DISCLOSURES

In compliance with the requirements set forth by Revenue Regulation No. 15-2010, hereunder are the information on taxes, duties and licenses fees paid or accrued during the taxable year:

A. Value-Added Tax

PPPI is a VAT-registered company with VAT output tax declaration during the year of ₱18,581,685 based on sales and other income totaling ₱154,847,376. On the other hand, the amount of VAT Input taxes claimed are broken down as follows:

Beginning balance		318,430
Add: Purchases during the year:		
1. On goods for resale	15,598,490	
2. On goods other than for resale	20,895	
3. Capital goods not subject for amortization	0	
4. On services lodged under cost of goods sold	0	
5. On services lodged under other accounts	2,835,496	18,454,881
Sub-total		<u>18,773,311</u>
Less: Input VAT charged to expense		<u>6,147,861</u>
Ending balance		<u>12,625,450</u>

B. Other taxes and licenses paid during the year:

Local

1. Business taxes and fees	3,550,526
2. Barangay clearance/Community Tax Certificate	13,989
3. City taxes	50,860

National

1. BIR annual registration	500
2. Various licenses	9,231
3. LTO renewal	16,680
4. Others	3,367

C. Taxes withheld and remitted during the year:

1. Tax on compensation and benefits	1,786,427
2. Expanded withholding taxes	5,094,867
3. Final withholding taxes	24,055,661
4. Creditable tax withheld at source	3,415,520
5. Final tax withheld at source	15,354,394

D. Tax Cases

PPPI has pending Final Decision on Disputed Assessment (FDDA) from Revenue District Office No. 50 amounting to P7,897,294 inclusive of interest as of December 31, 2012 for income tax deficiency covering the taxable year 2007. A Protest-Letter was filed in October 2012 disputing the amended assessment. The protest is still under investigation.

On December 29, 2015, a Preliminary Assessment Notice from Revenue District Office No. 50 was received for the tax deficiencies amounting to P29,154,790 for Income Tax, P4,108,306 for Value-Added Tax, P1,112,008 for Expanded Withholding Tax, P909,163 for Withholding Tax on Compensation, and P4,761,813 for Documentary Stamp Tax for the taxable year 2011.

In August 2015, a Letter of Authority from Revenue District Office No. 50 was received for the taxable year 2014. BIR returns, schedules and all necessary documents were transmitted for BIR audit.