EXECUTIVE SUMMARY

A. Introduction

Power Sector Assets and Liabilities Management (PSALM) Corporation

1. PSALM Corporation was created under the Electric Power Industry Reform Act of 2001 (EPIRA) primarily for the following purposes:

   a. To take ownership of all the existing generation assets, independent power producer (IPP) contracts, real estate and all other disposable assets, and to assume all liabilities and obligations of the National Power Corporation (NPC) and manage the orderly sale, disposition and privatization of NPC's assets with the objective of liquidating in an optimal manner all of NPC's financial obligations and stranded contract costs;

   b. To assume all outstanding financial obligations of Rural Electric Cooperatives (REC) to National Electric Administration (NEA) and other government agencies incurred for the purpose of financing the Rural Electrification Program (REP). Section 2, Rule 31 of the Implementing Rules and Regulations of EPIRA states that the assumption covers all outstanding REP-related financial obligations of the RECs as of June 26, 2001; and

   c. To collect, administer and apply NPC's portion of the universal charge (UC). The UC is a non-bypassable charge which is passed on and collected from all end-users on a monthly basis by the distribution utilities. The collections by the distribution utilities and National Transmission Corporation (TransCo) in any given month shall be remitted to PSALM Corporation on or before the fifteenth (15^{th}) of the succeeding month. Any end-user or self-generating entity not connected to a distribution utility shall remit its corresponding UC directly to TransCo.

2. The powers and functions of PSALM Corporation are vested and exercised by a Board of Directors composed of the Secretary of Finance as Chairman, Secretary of Energy as Vice Chairman, Secretary of Budget and Management, Secretary of Socio Economic Planning and Director-General of National Economic and Development Authority, Secretary of Justice, Secretary of Department of Trade and Industry, and the President and Chief Executive Officer of PSALM as members.

Scope and Objectives of Audit

3. The audit covered the accounts and operations of the PSALM Corporation for CY 2017. It was conducted in accordance with Philippine Public Sector Standards on Auditing, on a test basis, to determine the (a) level of assurance that may be placed on the Management's assertions on the financial statements; (b) the propriety of transactions as well as compliance with existing rules and regulation as well as Management's policies; and (c) the extent of the implementation of prior year's audit recommendations.

B. **Financial Highlights**

The PSALM Corporation's financial condition, results of operation and sources and application of funds for CY 2017 compared with that of the previous year are as follows:

Financial Condition

	2017	2016 As restated	Increase/ (Decrease)
Assets	788,811,949,589	808,775,993,869	(19,964,044,280)
Liabilities	757,010,319,321	738,810,095,120	18,200,224,201
Equity	**31,801,630,268**	**69,965,898,749**	**(38,164,268,481)**

Results of Operations

	2017	2016	Increase/ (Decrease)
Income	78,335,877,898	79,188,880,121	(853,002,223)
Expenses	82,605,324,273	94,044,693,277	(11,439,369,004)
Net Income (Loss)	**(4,269,446,375)**	**(14,855,813,156)**	**(10,586,366,781)**

Budget Utilization

	Approved Budget	Obligations	Balance
PS	606,720,278	482,727,009	123,993,269
MOOE	109,982,014,640	71,858,789,295	38,123,225,345
CO	2,791,028,780	1,180,212,026	1,610,816,754
Total	**113,379,763,698**	**73,521,728,330**	**39,858,035,368**

C. **Auditor's Opinion**

We rendered a qualified opinion on the fairness of the presentation of the CYs 2017 and 2016 financial statements due to the following:

a. The Property, Plant and Equipment (PPE) in the amount of P3.864 billion and P2.007 billion for CYs 2017 and 2016, respectively, with a carrying net book value of P19.074 billion and P25.894 billion as of December 31, 2017 and December 31, 2016, respectively, was not fairly presented as required under the Conceptual Framework and Philippine Public Sector Accounting Standards (PPSAS) 1 because the existence of transferred assets from National Power Corporation (NPC) in the amount of P2.059 billion was doubtful due to its non inclusion in the Physical Inventory Report. Moreover, several unserviceable properties in the power plants amounting to P1.142 billion remained undisposed as of year-end. Also, the book balance of the PSALM-Acquired Assets in the amount of P48.525 million was not reconciled with the physical inventory report for CY 2017 and the transmission-related assets owned by the National Transmission Corporation (TransCo) amounting to P125.346 million were included in the PPE account. Likewise, allowance for depreciation was not provided on the assets from Privatized Independent Power Producers (IPPs) with carrying value of P470.321 million and Other Utility Plants amounting to P17.979 million.

b. The Inter-Agency Receivables consisting of Due from National Government Agencies (NGAs) account in the aggregate amount of P15.134 billion and P53.709 billion, as of December 31, 2017 and 2016, respectively, was not reliable due to the negative results of confirmation with net discrepancy of P10.033 billion between the records of PSALM and the other Government Agencies, inclusion of dormant accounts transferred from NPC books in CY 2009 in the amount of P11.118 billion, inclusion of the prepayment accounts totaling P190.892 million consisting of various creditable withholding taxes which is not in compliance with COA Circular 2015-010 (Revised Chart of Accounts for Government Owned and Controlled Corporation) and PPSAS 1 and Tax withheld on the disallowed payment to PSALM officers and employees amounting to P11.026 million was adjusted twice in the books resulting to understatement of Inter-Agency Receivables - Due from NGAs account.

c. The accuracy and reliability of the accounts Prepayment accounts - BIR - Input VAT and BIR – CWT in the amount of P34.444 billion and P37.669 billion, as of December 31, 2017 and December 31, 2016, respectively, were not ascertained due to a significant variance of P13.014 billion between the total amount of Input VAT presented in the VAT Returns or BIR Forms 2550Q and the general ledger account balance for Input VAT account, and the amount reported in the Annual Income Tax Return or BIR Form 1702 and the Creditable Withholding Tax account ledger in the amount of P432.031 million contrary to the Conceptual Framework on General Purpose Financial Statements and PPSAS 1.

D. **Other Significant Audit Observations**

In addition to the audit observations which we considered in the formulation of our qualified opinion, presented below are other significant audit observations and recommendations, which are discussed in detail in Part II of the Report.

1. PSALM lost the opportunity to lessen future tax liability by P4.254 billion due to non-disclosure in the Notes to Financial Statements and separately show in the Income Tax Returns the Carry Forward Benefits from CYs 2013 to 2014 such as Net Operating Loss Carry-Over (NOLCO) and Excess of the Minimum Corporate Income Tax (MCIT), a remedy allowed under the National Internal Revenue Code.

   Recommendations:

   a. *Recognize and present in the Income Tax Returns and Financial Statements the amount of NOLCO and excess MCIT as a requirement for tax deductions, a remedy allowed under National Internal Revenue Code;*

   b. *Recognize and disclose in the Financial Statements the deferred tax asset arising from the temporary differences and deferred tax asset arising from unused tax losses and unused tax credits since these items will be used as payment for its income tax dues in accordance with PPSAS 1 on the recognition and presentation of assets and PAS 12 on accounting for income taxes; and*

c. *Require concerned officials to fully understand the provisions of tax rules and the benefits that maybe availed of and the remedies of the opportunity lost.*

2. PSALM Corporation's Asset held in Trust with NPC account balance of P8.398 billion remained unreconciled, with a difference of P47.824 billion when compared with the Trust Liability to PSALM account balance of P39.426 billion, the reciprocal account being maintained by the NPC, although a Task Force was created in CY 2011 to reconcile the account balances. Thus, the fair presentation of the account balance as required in PPSAS 1 was doubtful.

   Recommendations:

   a. *Coordinate with NPC to recreate a joint task force responsible for the reconciliation of the accounts within a prescribed deadline. From the results of the reconciliation, prepare and effect the appropriate adjusting entries to clean the accounts; and*

   b. *Demand for the physical transfer of the cash and cash equivalent including all supporting documents based on the reconciled amount considering that the same was already recorded in the books of PSALM pursuant to Rule 21 Section 1 of the IRR of EPIRA law.*

3. Land covered by a Land Lease Agreement (LLA) between NPC/PSALM and Maibarara Geothermal, Inc with an area of 96,062 sq.m. was not recorded in the books. On the other hand, land owned by TransCo in the amount of P21.603 million covered by LLA for the Bataan Combined Cycle Power Plant (CCPP) was recorded in the books. Thus, the Investment Property - Land account with year end balance of P1.605 billion was not correctly stated contrary to the Conceptual Framework and PPSAS 1.

   Recommendations:

   a. *Coordinate with the Asset Valuation and Disposal Department on securing the land title for the land in Sto. Tomas, Batangas covered by Land Lease Agreement and all other lands that may be covered with LLA for recording in the books; and*

   b. *Verify if the land excluded from the LLA in Bataan CCPP is owned by TransCo; thereafter, as necessary, prepare adjusting entry for dropping from the books.*

4. PSALM Corporation was deprived of UC fund for CY 2017 in the amount of P80.731 million which could have been made available to UC beneficiaries pursuant to the guidelines under ERC Case No. 2003-187 due to:

   a. The non-remittance of the UC collecting entities/distribution utilities (CEs/DUs) and non-submission of monthly statement of billing and statement of collection/remittance for the amount of P64.087 million;

b. PSALM Corporation has not taken any collection effort on UCs amounting to P5.051 million from some CEs/DUs which remained outstanding for more than two months as required under ERC Case No. 2003-187; and

c. Non-recording of receivable from penalties/interest of 14 out of 64 defaulting CEs/DUs that have been assessed for delayed remittance of UC collections to PSALM Main Trust Fund-UC in the amount of P11.593 million.

Recommendations:

a. Require Universal Charge Administration Department (UCAD) to account and establish the outstanding UC receivables from the six non-complying Collecting Entities/Distribution Utilities (CEs/DUs) as at year-end and record the same in the books;

b. Demand from the DUs/ECs for the immediate remittance of the computed outstanding UC receivable;

c. Require UCAD to establish the actual penalties of defaulting CEs/DUs and submit the computation and monitoring of outstanding UC balance of penalties as at year end to Controllership Department for recording in the books; and

d. Comply with the remedy provided in Section 5.02 (e) of the guideline approved under ERC Case No. 2003-187 and Rule 18 of the IRR of the EPIRA Law, in case the Collecting Entity was consistently delayed in or failed to remit its collections for more than two months.

E. Status of Audit Suspensions, Disallowances and Charges

Per Statement of Audit Suspensions, Disallowances and Charges (SASDC) issued as of December 31, 2017, the unsettled audit disallowances amounted to P314.833 million. Details are shown in Part II of the Report.

F. Status of Implementation of Prior Year's Audit Recommendations

Of the 56 audit recommendations embodied in the 2016 Annual Audit Report, 31 were fully implemented, 9 were partially implemented and 16 were not implemented and thus, reiterated in Part II of the Report. Details are found in Part III of the Report.