

THE BOARD OF DIRECTORS
North Luzon Railways Corporation
2/F Old Officers' Clubhouse
JUSMAG Area
Philippine Army Recreation Center
Fort Bonifacio, Taguig, Metro Manila

We have audited the accompanying balance sheet of North Luzon Railways Corporation, a pre-operating subsidiary of the Bases Conversion Development Authority, as of December 31, 2003. This balance sheet is the responsibility of the Corporation's management. Our responsibility is to express an opinion on this balance sheet based on our audit.

We conducted our audit in accordance with laws, Commission on Audit and International Organization of Supreme Audit Institutions standards and applicable generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the balance sheet referred to above presents fairly, in all material respects, the financial position of North Luzon Railways Corporation as of December 31, 2003 in conformity with applicable generally accepted accounting principles.

As discussed in Note 1, the Corporation was incorporated on August 22, 1995 to develop, construct, operate and manage a railroad system to serve Metro Manila, Central and Northern Luzon. The Corporation's activities are limited to the advance works that include engineering studies; basic design, securing permits and environmental clearances, squatter relocation and packaging the project for financing from international institutions.

COMMISSION ON AUDIT

By:

MA. CRISTINA D. DIMAGIBA
Officer-in-Charge

March 22, 2004

COMMENTS AND OBSERVATIONS

1. **The Corporation has already released a total of P118.185 million to the Province of Bulacan (POB) yet relocation of affected families, construction of access road and clearing of PNR ROW has not been implemented/completed.**

The Corporation, the POB, and the Alto Project Asia, Inc. (APAI) executed a Memorandum of Agreement dated March 7, 1999, which provides, among others, the following:

- Northrail shall provide financial support to the POB up to a maximum amount of P52.5 million for the relocation of affected families within Bulacan. The amount was determined on the basis of P5,000 per family for 10,500 affected families.
- Northrail's fund releases of P15 million (which is part of P52.5 million) would be used by the POB for the first 2,000 relocatees.
- Northrail shall fund the construction of about 12-kilometer access road that will connect the relocation site to the main highway.
- Northrail shall provide an additional sum of P5 million to fund a project management office to be established by the POB to administer the relocation and resettlement activities in Bulacan including the monitoring of APAI undertakings and accomplishments.
- The POB shall see to it that PNR ROW will be cleared starting May 1, 1999 and relocation of affected families will be finished not later than June 30, 2001.
- The POB shall pass a Board Resolution expressing its commitment to implement the terms of this MOA even if the implementation period goes beyond the terms of office of the signatories.
- APAI shall assist in the demolition of housing units on PNR ROW and transport relocatees to the relocation site beginning May 1, 1999. All affected families must be relocated not later than June 30, 2001.

Another Addendum to the MOA was executed on October 25, 2002 rescheduling the full implementation and completion of the relocation and resettlement program from June 30, 2001 to October 30, 2005. The revised Master Development Schedule showed that Access Road shall be done by January 2003; site development of 10 hectares shall be completed by November 2003; 10,000 housing units by October 2005 and relocation of beneficiaries shall start by March 2003.

As of December 31, 2003, the Corporation has released P118.185 million to the POB for the following:

Bulacan relocation program	15.458 M
Project management office	3.184 M
Construction of access road	99.543 M
	<u>P118.185 M</u>

The financial support of P15.458 million released to the POB is allocated for the relocation of 2,000 families. However, not even a single family was relocated to the housing project in spite of the initial commitment of POB and APAI that the 10,500 affected families be relocated not later than June 30, 2001.

In relation to this relocation program, the Northrail donated 60-hectare land to the POB to be used as relocation site. The POB and APAI entered into a joint-venture agreement to develop the said property and to construct 10,500 low-cost residential houses for relocatees.

APAI has already changed their commitment thrice: the original commitment of 10,500 units by June 30, 2001; the revised commitment dated January 2002 of 10,000 houses by December 2003; and the latest commitment dated October 25, 2002 of 10,000 houses by October 2005.

Inspection of the site revealed that the primary reason for non-relocation is the inability of APAI and POB to construct and finish the required number of low-cost housing units. Based on its latest commitment, it should have constructed 2,026 units as of December 2003 but Northrail's Status Report showed that there are only 57 housing units in different stages of construction:

No. of units	% of Completion
30	100
7	95
16	70
4	5
<u>57</u>	

In addition, APAI has not yet acquired land adjacent to the relocation site wherein an agro-industrial estate is supposed to be developed and operated to assure livelihood and employment opportunities for relocatees.

Sixty-four percent (64%) of the P5 million allotted for the POB-Project Monitoring Office or P3.184 million was already disbursed despite the fact that no material accomplishment has been achieved in the relocation program and monitoring activities.

The Northrail is responsible for financing the construction of 12-kilometer concrete road that will provide an easy access to the relocation site. The construction and development of the initial 8.7-kilometer portion of access road was awarded to APAI by the POB. This road was originally scheduled to be completed for 180 days ending March 2000 and later rescheduled to be done by January 2003. To date, the access road is only 85% completed. No penalty was imposed for the substantial delay of the project. APAI claimed that the delay was due to bad weather conditions and right-of-way problems.

We recommended to Management the following:

- a) Recommend to POB the imposition of liquidated damages for any unjustified delay by APAI in the delivery of low-cost housing units and completion of access road.
- b) Release funds for the PMO based not only on the amount expended but also on the percentage of accomplishments. Based on the reimbursements made to the PMO, there is a possibility that the P5 million allocation will be exhausted before the relocation and resettlement project is completed.

APAI claims that the failure of Northrail to transfer the remaining 103 hectares is delaying the development of the relocation site. On the other hand, Management decided to withhold the turn over of the remaining areas until the initial area of 60 hectares is fully developed and ready for occupancy.

Judging on APAI's accomplishment on the project, we concur with Management's stand of withholding the turn over of the remaining areas to APAI.

2. Deduction of interest on APAI'S P15 million loan from its retention fee based on bank's current rate is disadvantageous to the government.

Section 1.2 of the Third Addendum to the Memorandum of Agreement (as discussed in Finding No. 1) provides that APAI shall pay the interest that accrued on the amount loaned up until the complete repayment of the same which shall be deducted from APAI's retention fee.

In the original MOA dated March 7, 1999, one of the provisions therein was for Northrail to grant a loan of P15 million to APAI to jump start site development of the housing area in Norzagaray, Bulacan. This was granted on June 11, 1999 and paid by APAI on December 15, 1999. In our 1999 audit, we questioned the propriety of the grant of P15 million interest-free loan to APAI, citing therein the amount they could have earned if it was invested based on the prevailing interest rate.

In our 2000 audit, we called Management's attention for not collecting the interest of P595,333, net of taxes. This was computed based on the 1999 prevailing interest rate of 9.5% per year for 188 days. One of our recommendations was to deduct the same from APAI's progress billing.

In January 2002, Management replied that they already billed APAI for the interest of 6% due on the P15 million loan amounting to P376,000, net of tax. This is based on the bank's current rate. The interest will be deducted from the retention fee, instead of APAI's progress billing.

We reiterate our recommendation that the interest of P595,333, which was computed based on the 1999 prevailing interest rate, be charged to APAI. The loan was granted in June 1999 and paid in December 1999. It is not fair to the government that lower interest rate be used.

It is further recommended that additional interest be imposed on the P595,333 until its complete repayment in as much as it was allowed that the same shall be deducted from APAI's retention fee. Had APAI paid the amount in December 1999, the Corporation could have invested it in short-term investment and could have made additional earnings.

Management stated that the MOA did not provide for the collection of interest by Northrail from APAI for the said loan. They further explained that the interest rate of 6% was already incorporated in the 3rd Addendum to the MOA so Northrail has no recourse on the increase of the rate as this already constitutes a contractual arrangement between the Corporation and APAI.

3. The contract entered into between Northrail and Container Bridge Philippines, Inc. (CBPI) is deemed disadvantageous to the government.

The Northrail management as authorized by its Board of Directors procured and contracted through negotiated mode of procurement the services of CBPI in handling the ex-works, transport, unloading, and brokerage of the donated train coaches from Japan to Manila (ICTSI) port railheads.

Review of the aforesaid contract however, revealed the following infirmities:

- a) Provision for the advance payment of P 15 million payable upon the signing of the contract to cover ex-works charges (Article 3.1.m.) in clear violation of the law;

- b) Absence of provision for the duration of the contract/services, so the contractor could just take his time; and
- c) Absence of provision as to the extent of the liability of the contractor in case of delay/non-performance of services, so the contractor was not liable for any delay and just perform the services suitable to his convenience and to the detriment of Northrail.

Prohibition against advance payment on government contracts is specifically provided under P.D. No. 1445, which reads:

"SECTION 88. Prohibition against advance payment on government contracts. – (1) Except with the prior approval of the President (Prime Minister) the government shall not be obliged to make an advance payment for services not yet rendered or for supplies and materials not yet delivered under any contract therefor. No payment, partial or final, shall be made on any such contract except upon a certification by the head of the agency concerned to the effect that the services or supplies and materials have been rendered or delivered in accordance with the terms of the contract and have been duly inspected and accepted. xxx".

Due to the non-compliance with the law on the prohibition on advance payment as required and the apparent infirmities in the contract as above enumerated, the government was deemed placed in a very disadvantageous position, where Northrail interests have not been amply protected.

We recommended that Management render explanation why it entered into such onerous contract.

Management replied that it is not their intention to enter into a contract which will prove to be onerous to the government. They have in fact submitted the contract to OGCC for its opinion. They will take note of the COA finding for future reference in their contracts. They further mentioned that the train coaches are already in the country and were inaugurated during the groundbreaking ceremony for the Northrail project.

4. Deficiencies were noted on the grant, utilization and liquidation of cash advances.

Section 176 of the Government Accounting and Auditing Manual (GAAM) provides that, "Cash advance for petty operating expenses shall be sufficient for the recurring expenses of the agency for one month. The accountable officer may request for replenishment of the cash advance when the disbursements reach at least 75 % or as the need requires, by submitting a replenishment voucher with all supporting documents duly summarized in a report of disbursements. This fund shall not be used for payment of regular expenses such as rentals, subscriptions, light and water and the like."

Section 179 further states that, "For petty operating expenses and field operating expenses, the accountable officer shall liquidate his cash advance within 20 days after the end of the year; subject to replenishments during the year. When a cash advance is no longer needed or has not been used for a period of two (2) months, it must be returned to or deposited immediately with the collecting officer. All cash advances shall be fully liquidated at the end of each year except for petty cash fund. The Accountable Officer shall refund any unexpended balance to the Cashier/Collecting Officer who will issue the necessary official receipt."

Section 182, on the other hand, asserts that, "Each accountable officer with a total cash accountability of P2,000.00 or more shall be bonded with the Bureau of the Treasury

Fidelity Bond Division The amount of the bond shall depend on the total accountability (cash and cash items) of the officer as fixed by the head of the agency.”

Verification of the Petty Cash Fund replenishments for the year 2003 revealed that these were made below the required limit of at least 75% of the total fund. The average monthly replenishment is P 11,257.84. which is only 38% of the entire fund. This indicates that the estimated amount of the fund amounting to P30,000.00 is more than half of the actual/necessary monthly expenses. Consequently, there is an idle portion of the fund which could be invested by the Corporation and yield interest.

The Corporation incurred expenses that were regular in nature and paid them out of the Petty Cash Fund such as newspaper subscriptions and light and water. These regular expenses could be paid conveniently by check and instant payment is not a must.

It was also noted that cash advances granted to Special Disbursing Officers were not liquidated on time. The unused funds were kept in the custody of the accountable officers for some months instead of returning them to the collecting officer for deposit. This is contrary to prescribed rules and regulations which require the accountable officers to return immediately to the collecting officer cash advances that have not been used for a period of two months and to liquidate all cash advances within 20 days after the end of the year.

Furthermore, no amount of insurance had been paid to the Bureau of Treasury as fidelity bond for the above mentioned accountable officers.

We recommended to Management the following:

- a) Require the explanation of the accountable officers for their failure to immediately liquidate their cash advances / refund unused cash advances.
- b) Strictly adhere to the prescribed laws, rules and regulations on proper handling of cash advances and bonding of accountable officers.
- c) Review the monthly requirement for petty operating expenses and reduce the fund, if necessary.

Management explained that replenishments of the petty cash fund were prepared in advance because signing of checks depends on the availability of the check signatories who are not reporting full time at Northrail. They further stated that checks for the replenishment are not immediately encashed with the bank until the need arises. For regular expenses like newspaper subscriptions, they will already pay it through checks.

Management also explained that due to some problems in the geodetic survey and the busy schedules of the accountable officers, they were not able to liquidate at once their cash advances.

We, however, contend that accountable officers are bound to observe the prescribed time for the liquidation of their cash advances no matter how busy their schedules are.

5. Rental deposits amounting to P 240,000 remained outstanding in the books since 1998 despite the expiration of the lease contracts.

In 1997, Northrail entered into lease contracts with Homebase Product Trading, Inc. (HBTI) and Overseas Pacific Limited (OPL) for the lease of two condominium units to house its foreign consultants. Northrail paid security deposits equivalent to two (2) months rent amounting to P 120,000 for each lease contract which shall answer for any

unpaid bills for the utilities such as electricity, water, telephone, skycable and any damages to the leased premises that would be attributed to the lessee.

The lease contract with HBTI expired on April 17, 1998 while that of OPL expired on March 7, 1998. Verification of records showed that said security deposits still remained outstanding in the books as of December 31, 2003. In reply to the confirmation letter sent to HBTI, they claimed that they have already applied the deposit to Northrail's' existing obligations then. On the other hand, efforts to contact OPL produced negative results.

We reiterate our recommendation to check whether the Corporation have existing obligations with HBTI and OPL. Otherwise, they should enforce necessary measures to collect the rental deposits due from them.

Management replied that they will implement immediate actions to check whether said corporations still exist and determine whether Northrail has existing obligations or receivables.

6. Management granted P30,000 Christmas package to regular employees despite limited funds and to members of the Board of Directors who are non-salaried officials of the Corporation.

At present, Northrail is in the pre-operating stage and sources its fund from BCDA in the form of advances. During the year, BCDA earmarked the rental payments of MIAA to support the Northrail project.

Relative to the grant of year-end benefits to the members of the Board of Directors, DBM Circular No. 2002-2 dated January 2, 2002 states that personnel economic relief allowance (PERA), year-end benefits, additional compensation and retirement benefits are personnel benefits granted in addition to salaries. As fringe benefits, these shall be paid only when the basic salary is also paid. Members and Ex-Officio members of the Board of Directors are not salaried officials of the government, hence, they are not entitled to these benefits unless expressly provided by law.

Audit of Personal Services account revealed that Northrail paid on October 2 and 10, 2003, Christmas package of P 30,000 each to all regular employees and members of the Board of Directors on the basis of Board Resolution No. BD 09-18-03-006 dated September 18, 2003. A total of P 342,000 was paid to the twelve (12) regular employees and P 300,000 to the ten (10) members of the board. Compared to the previous year's budget, there was an increase of P 228,000 for Christmas package of regular employees. On the other hand, the members of the Board of Directors are not salaried officials of Northrail, hence, they are not entitled to year-end benefits.

Considering that the Corporation is still in its pre-operating stage and is not earning income yet, it would be prudent to set priorities for the use of its limited funds. Moreover, the proposed budget of BCDA, its parent company, for P30,000 Christmas package was disallowed by DBM and was approved only for P10,000. In as much as Northrail gets its budget from BCDA, it is expected that same prohibition will also apply to the Corporation.

We recommended to Management the following:

- a) Render an explanation why payment of the Christmas package should not be disallowed in audit.
- b) Grant Christmas package (Christmas gift check) only to salaried officials of the Corporation.

Management cited RA 7227 empowering the board of directors of subsidiaries to establish their pay plan as their reference in granting the Christmas package. With the similar finding of BCDA grant, Northrail will await the decision on the request for reconsideration by BCDA and/or apply for subsequent approval of the Office of the President. Should both options be denied, the Corporation shall effect a salary deduction to recover the amounts from its employees over a period of one year.

With regard to the directors, Management maintains that they work equally as hard as the employees and are even more accountable in terms of policy directions. Should the response to their appeal be negative, the amount shall be deducted from the honoraria of the directors for four consecutive meetings until the entire amount is recovered.

7. Payment of 15% salary increase to regular employees was made without prior approval from the Office of the President (OP) and despite the pre-operating status of the Corporation and its limited funds.

Memorandum Order No. 20 dated June 25, 2001 directs the immediate suspension of the grant of any salary increase and new or increased benefits of senior officers, including members of the Board of Directors of government-owned-and-controlled corporations (GOCCs), government financial institutions (GFIs) and subsidiaries. Any increase in salary or compensation of GOCCs/GFIs that are not in accordance with the Salary Standardization Law shall be subject to the approval of the President.

Audit of Personal Services account revealed that Northrail paid on November 28, 2003, 15% salary increase to its officers and employees retroactive October, 2003 on the basis of Board Resolution # BD 11-13-03-006 dated November 13, 2003. Said increase was also granted to officers and employees of BCDA, its parent company. However, verification disclosed that the DBM disallowed the BCDA's budget for said increase including the corresponding adjustment on 13th month pay, overtime pay and other benefits. Considering that Northrail is not earning income yet and still gets its budget from BCDA, it is expected that same prohibition will also apply to the Corporation.

We recommended to Management the following:

- a) Stop the grant of 15% across-the-board salary increase until OP approval is secured.
- b) Require all Northrail employees to refund the 15% salary increase from October 2003 to present including all pay differentials made to all allowances using the adjusted rates.

Management explained that they will immediately withhold grant of the salary increase to its employees until such time that there is a favorable response to BCDA's request for reconsideration and/or subsequent approval of the OP. Should the response to their request be negative, the same will be deducted from the salaries of the employees over a period of one year or until the amount is fully recovered.

8. Honoraria were granted to SPBAC and TWG members prior to the promulgation of the necessary guidelines by the Department of Budget and Management (DBM).

R.A. No. 9184, otherwise known as the "Government Procurement Reform Act" and its Implementing Rules and Regulations (IRRs) provides payment of honoraria to BAC Members, thus:

" Section 15. Honoraria of BAC Members.- The Procuring Entity may grant payment of honoraria to the BAC members in an amount not to exceed twenty five percent (25%) of their respective basic monthly salary subject to availability of funds. For this purpose, the Department of Budget and Management (DBM) shall promulgate the necessary guidelines." (RA 9184), and

" Section 15. Honoraria of BAC and TWG Members - The Procuring Entity may grant payment of honoraria to the BAC members in an amount not to exceed twenty five percent (25%) of their respective basic monthly salary, subject to availability of funds. For this purpose, the DBM shall promulgate the necessary guidelines. The Procuring Entity may also grant payment of honoraria to the TWG members, subject to the relevant rules of the DBM." (IRRs, RA 9184)

On September 18, 2003, the Northrail Board approved the grant of monthly honoraria to the chairman and members of the Special Procurement, Bids and Award Committees (SPBAC) amounting to P3,500 and P3,000, respectively, through Board Resolution No. BD 09-18-03-008. Audit of the related expense account revealed that Northrail paid honoraria to the members of the SPBAC and TWG covering the period June to August 2003 based on this (Board) Resolution through checks totaling P65,875.00.

We believe that while Northrail may grant payment of honoraria to the SPBAC and TWG members under the law, said authority is subject to the promulgation of the necessary guidelines by the DBM. This requirement has not been issued at the time of payment, hence, there was no basis for the grant of honoraria.

We recommended that Management render explanation why these payments should not be disallowed in audit.

Management explained that payment of the honoraria was based on the BCDA grant of the same allowance to its BAC and TWG members. With the promulgation of the DBM guidelines that honoraria will only be granted for successful bidding, they will withhold payment of honoraria in the succeeding bidding to recover the excess amount paid. The Northrail SPBAC and TWG members were able to successfully bid out two projects.

9. Management failed to conduct physical inventory of its Property and Equipment during the year thereby affecting the reliability and accuracy of the account balance as of December 31, 2003.

The Corporation failed to conduct physical inventory of its Properties and Equipment as of year-end. Thus, the reconciliation process between records and physical inventory cannot be made rendering the balance of the account doubtful as of December 31, 2003.

We recommended that Management conduct physical inventory of its property and equipment at least once a year, prepare report on the result of the inventory and facilitate the reconciliation process between accounting records and physical inventory count.

Management explained that due to the scheduled transfer of BCDA offices to Fort Bonifacio, Taguig on March 26, 2004, they have decided to conduct the physical inventory after they have transferred to their new office.

10. Suspense Account in the amount of P13,913.83 is still carried in the books.

Suspense account is a temporary account that should be cleared at the end of the accounting period. As of December 31, 2003, this account showed a balance of P13,913.83 incurred in the reconciliation of various accounts.

Inquiry from Management revealed that no transactions or adjustments transpired from December 31, 1999 up to the present. Considering that this account had been inactive for 4 years, it is imperative that efforts should be made to properly adjust this account and be removed from the books.

We recommended that Management exert effort to locate the supporting documents and trace out the relevant transactions for proper adjustments.

Management replied that they will trace out the transactions to adjust this account as soon as they have transferred to their new office and organize their documents.