AUDITOR GENERAL'S DEPARTMENT

REGULATORY AUDIT

AND

FINANCIAL STATEMENTS ASSESSMENT

FACTORIES CORPORATION OF JAMAICA LIMITED (FCJ)

The Auditor General is appointed by the Governor General and is required by the Constitution, Financial Administration and Audit Act, other sundry acts and letters of engagement, to conduct audits at least once per year of the accounts, financial transactions, operations and financial statements of central government ministries and departments, local government agencies, statutory bodies and government companies.

The Department is headed by the Auditor General, Pamela Monroe Ellis, who submits her reports to the Speaker of the House of Representatives in accordance with Section 122 of the Constitution of Jamaica and Section 29 of the Financial Administration and Audit Act.

This report was prepared by the Auditor General's Department of Jamaica for presentation to the House of Representatives.

AUDITOR GENERAL'S DEPARTMENT
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Vision

Promoting a better country through effective audit scrutiny of Government operations

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TABLE OF CONTENTS

Foreword

The Board of a public body is required to submit an annual report including audited financial statements of the public body, to the responsible Minister as soon as possible after the end of each financial year, but not more than four months thereafter. The responsible Minister '*shall cause the report and statements to be laid on the Table of the House of Representatives and of the Senate*'.

This report comprises the findings from a regulatory audit as well as an assessment of the audited financial statements of the Factories Corporation of Jamaica (FCJ) conducted for the period FY2010/11 to FY2014/15.

The review, which involved an examination of the corporate governance practices of the FCJ as well as ratio analyses was undertaken to inform Parliament and guide the Public Accounts Committee (PAC) in their review of the performance of the FCJ. In accordance with the Public Bodies Management and Accountability (PMBA) Act, public entities are required to demonstrate prudent financial management of public resources in the context of the Fiscal Responsibility Framework.

The Financial Statements revealed a generally satisfactory state of affairs. However, FCJ's corporate governance arrangements should be reviewed and brought in line with the Public Bodies Management and Accountability Act and related frameworks.

Pamela Monroe Ellis, FCCA, FCA, CISA
Auditor General

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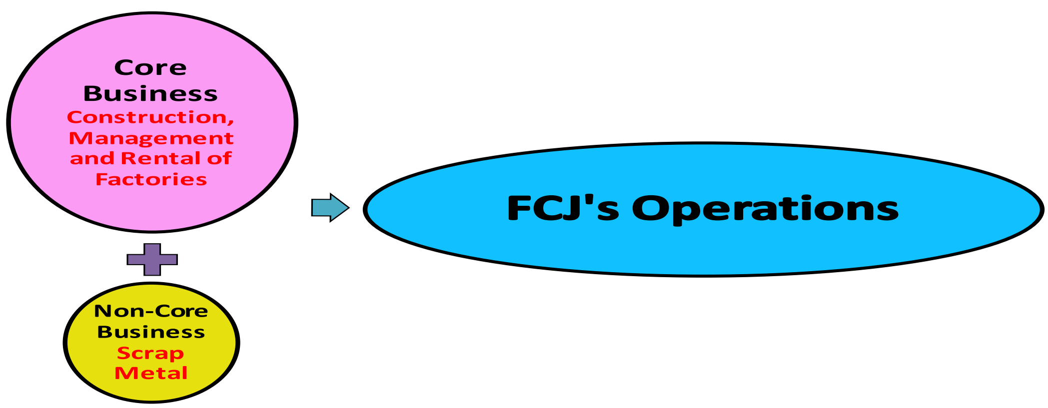
Executive Summary

Profile of the Company

i. The Factories Corporation Jamaica Limited (FCJ) is a fully owned Government entity, under the Ministry of Economic Growth and Job Creation within the Office of the Prime Minister[1]. The Company was incorporated under the Companies Act of Jamaica in 1987 to implement the Government's Emergency Factory Building Programme through which 92,903 square metres of factory space was built. The FCJ commenced operations in 1988 and with the phasing out of the Jamaica Industrial Development Corporation (JIDC) in 1989, its role was expanded to include the management of properties formerly under the JIDC's control. FCJ's mandate was broadened to that of being a catalyst for job creation, development and sustainable economic growth and includes the development and management of industrial and commercial space in the public sector. FCJ's role in supporting National Outcome #12 of Vision 2030 National Development Plan (NDP) is to ensure availability and access to competitive factory space as it seeks to develop internationally competitive industry structures.



Core Business

ii. FCJ's main activity is the construction, management and rental of factories. It is the largest provider of industrial and commercial real estate in Jamaica to a wide cross section of industries including manufacturing, food processing, and commercial activities. The entity owns 46 industrial sites comprising 169,157 square metres of factory space and approximately 78.4 hectares (193.6 acres) of vacant parcels of land as well as 200 acres at Caymanas Estate. As at December, 2015 the occupancy level was 90 per cent up from 78 per cent in FY2009/10.

[1]Up to March 2016, FCJ fell under the Ministry of Industry, Investment and Commence.

Non-Core Business

iii. In 2012, the scrap metal trade was added to FCJ's portfolio to improve the regulatory framework of the trade. The aim was to upgrade the operating and monitoring systems at the three approved multi-user scrap metal facilities, which were the only authorized industrial scrap metal exporters.

Audit Purpose

iv. We conducted a regulatory audit and reviewed the audited financial statements to determine whether FCJ conducts business in accordance with the laws and regulations that govern its operation as well as to assess the Corporation's financial performance. The regulatory audit and financial statement analysis covered the period April 2010 to November 2015. The report is divided into two sections:

- Regulatory audit
- Financial Statements Analysis

The key findings are outlined below in paragraphs 1 to 9.

Key Findings

Section One - Regulatory Audit

Concerns related to legal services

1. **FCJ decided to engage attorneys to provide conveyance services instead of using an in-house attorney.** Based on FCJ's salary scale, our estimate is that its legal costs in respect of emoluments would have been approximately $26.9 million for period March 2011 to December 2015, had FCJ use an in-house legal officer at the current salary level. However, in one instance, FCJ incurred legal fees of $48.9 million because the entity paid two separate firms of attorneys in relation to the same transaction. FCJ engaged two board members to provide conveyance services for the purchase of 200 acres of land, valued at $900 million from the Urban Development Corporation (UDC). The lawyers charged and were paid legal fees totalling $26.4 million. FCJ terminated the services of both board members in September 2012 after the sale agreement was stamped and the letter of possession received. FCJ then engaged another attorney in December 2014, to complete the same transaction for $22.5 million. In both instances, the lawyers charged two and half a percent of the sale price of $900 million.

   We noted that the vendor (UDC) utilized its own internal legal team for this transaction. The post of legal officer on FCJ's organisation structure has been vacant since January 2013. FCJ in its response of April 29, 2016 indicated that the Corporation received legal advice and opted not to use a staff attorney as he/she *"cannot give an undertaking in a conveyance matter unless that they are in possession of the funds. This would also be contravening the ethics of the governing profession. Government guidelines do not allow* *staff to be in possession of public funds"* FCJ did not provide evidence of the legal advice received in this regard.

In another matter, an attorney drawn from the panel did not hand over $70 million representing funds received up to February 23, 2011 from the sale of one of FCJ's properties. Since then, interest and penalties totalling $39.6 million have been applied to the outstanding amount. Subsequent to our audit, FCJ reported this matter to the Fraud Squad. Additionally, up to the time of reporting, FCJ had not taken steps to recover $750,000 advanced on December 22, 2011 to the said attorney contracted at a cost of $3.0 million to review the Corporation's Policy and Procedures Manual. The attorney did not deliver the draft manual and the service was terminated in September 2012. FCJ subsequently, engaged a former employee to develop the Policy and Procedures Manual at a cost of $750,000.

In none of the circumstances mentioned above did FCJ present for audit scrutiny, contract agreements setting out the terms and conditions for the engagement of all the attorneys. The absence of contract agreements highlights a lack of transparency and compromises FCJ's ability to protect public funds. The matter above pertaining to the attorney's delay in handing over the $109.6 million reinforces the importance of FCJ contemplating the use of internal legal services, to bring such transactions fully within the realm of the Government's accountability framework.

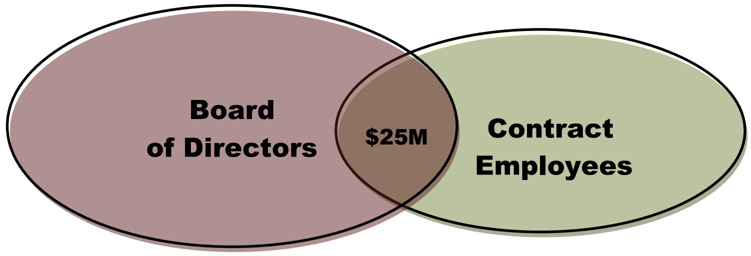
Weak Corporate Governance Practices

2. **FCJ paid five Board members remuneration amounting to $25 million for employment in key managerial positions.** We noted that prior to the decision to engage these five members, FCJ sought legal advice from the Company Secretary (an attorney on the Board) whose opinion supported the action, citing the Articles of Association dated October 9, 1987. However, the provisions of the Articles of Association are in conflict with the Government of Jamaica's (GOJ) Corporate Governance Framework[2]. Further, Section 6 (1) (a) of the Public Bodies Management and Accountability (PBMA) Act - the legal framework for public bodies, requires every board to take the necessary steps to ensure the accountability of all persons who manage the resources of the public body. In one instance, retroactive approval was received from the Ministry of Finance and the Public Service (MOFPS) for the engagement of one member. The Company Secretary also benefited from the arrangement and received payments amounting to $7.3 million for human resource and secretarial services between September 2012 and August 2013. However, despite our request, FCJ did not present the engagement letter setting out the terms and conditions of the arrangement.

   FCJ in its response indicated that the Board took the decision to implement a Temporary Management Oversight Team to achieve speedy implementation of the Scrap Metal Trade; obtain first hand information on critical areas, and oversee corrective action deemed threatening to the performance of the company. The Corporation also stated that the outcome of these arrangements was increased performance where profit moved from

[2] Principles 1(4) and 2(10) – The Board should retain full and effective control over the strategic direction of the Public Body while allowing the CEO take full responsibility for its day to day operations.

$329 million at end of 2010 to $627 million at the end of 2015. However, our review of the audited financial statements revealed that the reported net profits at end FY2009/10 and FY2014/15 were largely the result of revaluation adjustments in respect of properties **(Para. 2.0 to 2.2)**.



3. **FCJ engaged two consultants at a cost of $15.2 million between December 2011 and October, 2015, to perform operational tasks in the Human Resource and Accounting Units.** Despite FCJ's expression of concern that the Units did not possess the necessary competencies and skills to perform the specified tasks as well as the difficulties encountered in the movement of staff, we found no evidence that the Corporation did all it reasonably could to strengthen the capacity of these units. The minutes of the Human Resource Sub-Committee raised concerns about the competence of a senior officer who was engaged on contract. However, FCJ extended the contract of the senior officer three times since 2012. Subsequent to the extension of contracts, FCJ engaged a consultant to perform task that this senior officer should have carried out.

   Additionally, FCJ indicated that during the 2013/14 financial audit, the External Auditor had serious issues with the state of the accounts receivable; that would have resulted in the qualification of their report; as a result, a consultant was engaged to bring the accounts up to date. However, up to the time of reporting, this consultant was still engaged to provide services such as preparation of financial statements and reconciliation of GCT on receivables. We found no evidence that staff in the units were trained to undertake these tasks.

Delayed implementation of three development projects

4. In January 2011, Cabinet approved the development of 200 acres of land as a part of the Caymanas Economic Zone (CEZ) initiative. The CEZ forms part of the GOJ's Global Logistics Hub initiative that was conceptualized in 2008. Since conceptualisation, FCJ has incurred expenditure of approximately $190.2 million for which no benefit has yet been received. Further, FCJ should have commenced development of 100,000 square feet of factory space in Naggo Head in FY 2010/11. Since then FCJ has incurred expenditure of $25.3 million. FCJ subsequently indicated that a joint venture agreement was approved by Cabinet on January 11, 2016 and infrastructure work has since commenced.

   In 2009, FCJ earmarked the Garmex Free Zone and Commercial Complex for redevelopment as a part of the Logistic Hub Initiative. The redevelopment plan included the redesign of three existing buildings and entrance, construction of a new administrative building, multi-level parking garage and three (3) industrial buildings totalling 120,000 square feet of factory space. FCJ incurred expenditure totalling $64.0 million in 2009 for the development of tender documents and technical designs.

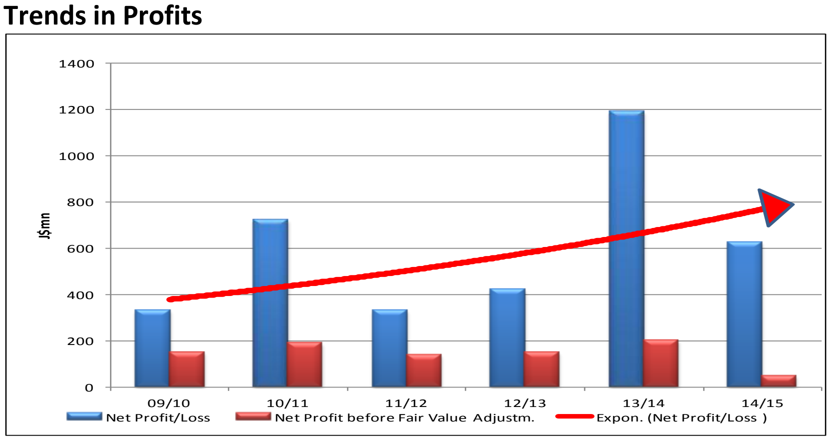
FCJ indicated that the delays in developing the projects were as a result of the change in the Portfolio Ministers; funding that was required; GOJ's instruction that no additional debt was to be incurred under the new IMF agreement; as well as pending decisions from both Cabinet and the Caymanas Special Economic Zone Enterprise Team, since 2013. FCJ neither provided documentary evidence of this instruction nor did the Board minutes reflect any discussion regarding the constraints being experienced. Further, for projects of this magnitude which were highly dependent on external factors, we would have expected FCJ to develop and implement risk mitigating strategies. We saw no evidence of such strategies or that the Parent Ministry provided monitoring and oversight for the planned developments.

5. **We noted that Cabinet approved the transfer of 11.58 acres of commercial land valued at $164 million[3] to a private trust for $10,000.** The Cabinet Decision indicated that the beneficiary of the Trust is the Community; however, we noted that the Directors of the Trust were three private individuals. The Trust was not registered with the Registrar General's Department or the Department of Co-Operative and Friendly Societies; hence we were unable to obtain a copy of the Trust Deed to validate the beneficiary of the Trust. Further, we noted that the title did not include a restrictive caveat to prevent the unauthorised disposal of the property in whole or in part. Consequently, we were unable to determine the terms and conditions governing the transfer.

Section Two - Financial Statements Analysis

6. **FCJ's net profit increased by $298.0 million or 90.6 per cent to $627.0 million over the six-year period ended March 31, 2015, largely reflecting the impact of valuation adjustments based on estimates of market prices for their investment properties**. Excluding these adjustments for fair value, net profit increased by only $7.5 million or 21.8 per cent over the period, indicating less robust performance from normal business activity.

Trends in Profits



Source: AuGD analysis of FCJ audited financial statements

[3] Book Value

7. FCJ's debt to total assets ratio fell to 0.06 at end FY2014/15 from 0.23 in FY2009/10. The relatively low ratio was largely reflective of FCJ's total assets which increased by 59.6 per cent to $9.4 billion in FY2014/15 from $5.9 billion in FY2009/10. However, the growth in assets was influenced by the cumulative valuation adjustments amounting to $3.1 billion in respect of investment properties. On the other hand, a 57.7 per cent fall in liabilities to $580.0 million in FY 2014/15 from $1.4 billion in FY 2009/10 reflected a 75.9 per cent contraction in long-term liabilities underpinned by elimination of deferred tax and a reduction in long-term debt obligations to the National Insurance Fund.

8. FCJ did not utilise its working capital efficiently to generate income over the review period as demonstrated by the working capital turnover ratio, which plummeted to 0.74 at end FY2014/15 (0.88 inclusive of scrap metal income) from 9.53 in FY2009/10. This was in a context where income increased at a significantly slower rate compared to growth in working capital.

9. FCJ's return on assets averaged 0.08 over the review period implying that in general, only $0.08 of net income was generated for every dollar of assets invested by the Corporation. Excluding fair value adjustment, return on assets averaged 0.01 over the review period further underscoring the inefficient use of assets to generate profit from core activities.

Recommendations

1. **FCJ should review its governance practices and implement systems to ensure that it is compliant with the PBMA Act and relevant regulations. Further, FCJ should conduct a comprehensive review of its human resource capacity to determine the requisite competences to support its core functions.**

2. **FCJ should take the necessary steps to recover monies held by attorneys on behalf of the Corporation as well as monies advanced for which no goods or services were received. Additionally, FCJ should implement proper systems to ensure efficient and economical use of its financial resources to meet its mandate.**

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Section One

Regulatory Audit

Introduction

1.1 The FCJ's mission is to "satisfy customer needs and enhance national development by providing quality industrial and commercial space, profitably."

1.2 The Board of Directors of Factories Corporation of Jamaica Limited (FCJ) has responsibility for corporate governance matters and is the prime decision-maker of the Company**.** The broad objective of the Board is to ensure that the policy directives of the Minister and the Government of Jamaica are implemented. In furtherance of the execution of its mandate, the Board is subdivided into five committees, chaired by five Board members (**Figure 1**).

Figure 1 List of Board Committees and Responsibilities

Board Committee	Responsibility
Finance	Term of reference not provided
Audit and Corporate Governance	Term of reference not provided
Human Resources and Administration	Term of reference not provided
Property Development and Marketing (PDM)	Term of reference not provided
ICT Infrastructure and Development	Term of reference not provided

Audit Scope and Methodology

1.3 We conducted a regulatory audit to determine whether FCJ's operations are being conducted in accordance with relevant laws and regulations. The audit included an assessment of the adequacy of FCJ's systems, policies and procedures that formed the enabling environment for the preservation of integrity and confidentiality of information, the achievement of the FCJ's business objectives and safeguarding of its assets. The audit covered the period April 2010 to March 2015 and where necessary we considered relevant information outside the audit period.

Our audit was planned and conducted in accordance with the Government Auditing Standards issued by the International Organization of Supreme Audit Institutions (INTOSAI). Our assessment was based on the review of internal and external documents, interviews with senior management and staff, observations, and information provided by FCJ.

Governance

1.4 In this section we report on whether FCJ has in place effective corporate governance mechanisms that would allow for strategic direction and effective oversight of the management, development and rental of factory spaces. The effectiveness of corporate governance would be manifested by the extent to which FCJ established and implemented formal procedures and internal control systems to improve accountability and transparency.

1.5 We expected FCJ to establish robust mechanisms to safeguard revenue earned and to ensure that resources are used economically, efficiently and effectively; also, that projects are properly planned and executed within budget, and to the required quality.

Concerns related to Legal Services

1.6 FCJ's approved organisation structure dated April 2011 included the post of a legal officer with an annual basic salary ranging from $2.4 million to $3.2 million, plus allowances. The post was filled in August 2011 and has been vacant since January 4, 2013. There is no evidence that FCJ took concrete steps to fill the post after it became vacant. Further, our review disclosed that FCJ paid $70.4 million for legal services between April 2011 and March 2015 to attorneys engaged from an approved panel of attorneys consisting of twelve persons. We observed that attorneys were added to the panel based on the Board's approval of his/her written request. However, we were unable to determine the basis on which attorneys were selected from the panel to represent the company, as there were no documented criteria.

1. 7 FCJ subsequently indicated that the Corporation received legal advice and opted not to use a staff attorney as he/she "cannot give an undertaking in a conveyance matter unless that they are in possession of the funds. This would also be contravening the ethics of the governing profession. Government guidelines do not allow staff to be in possession of public funds". However, FCJ did not provide evidence of the legal advice received in this regard.

1.8 We noted further breaches in FCJ's governance practices. Two Board Members expressed their interest to be added to the panel of attorneys in May and August 2010. Although the two members declared their interest to the Board, they did not recuse themselves from the Board Meeting of October 6, 2010 and November 11, 2010 when their requests were being considered and consequently, could still be deemed as influencing the outcomes. FCJ's records revealed that during their tenure, the attorneys represented the Company in eight legal matters and received fees totalling approximately $27.6 million.

1.9 We found that while being members of the Caymanas Economic Zone (CEZ) Committee, the two board members were asked in September 2010 to play lead roles in relation to the purchase of 200 acres of land from the Urban Development Corporation (UDC). FCJ did not provide the letter of engagement for review, despite our requests. However, we observed from the Board minutes that they were formally appointed in April 2011 to provide conveyance services for the same transaction. The two board members (attorneys) were paid the legal fees of $26.4 million (included in the $27.6 million para. 1.8). In September 2012, FCJ terminated their services after the sale agreement was stamped on June 28, 2011 and the letter of possession was granted on August 3, 2011. FCJ cited that the sale agreement negotiated did not represent Cabinet's intent.

1.10 In an attempt to complete the transaction, FCJ engaged another attorney in December 2014 at a cost of $22.5 million. The transaction was not finalised until January 28, 2016. To date, FCJ has paid $17 million to the attorney.

FCJ did not recover approximately $109.6 million for the sale of a Property

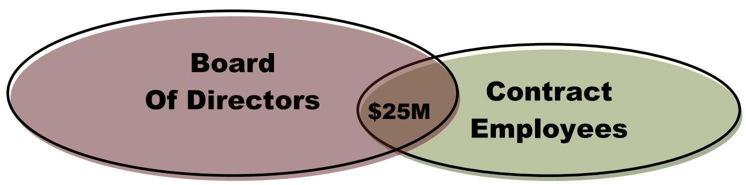
1.11 FCJ engaged an attorney (**Attorney 1**) in 2010 to represent them in the sale of one of its properties priced at $140 million. We noted from **Attorney 1's** statement of account dated April 29, 2014, that $142.6 million was owed to FCJ after deducting expenses from the sale proceeds and interest earned. However, contrary to the statement of account submitted by the attorney the relevant taxes were not paid and sale agreement filed. Consequently, FCJ incurred late fees and penalties; which have since been charged back to the attorney's account. FCJ subsequently engaged the services of another attorney (**Attorney 2**) in July 2014 to complete the sale of the property and recover the outstanding amount from first attorney. **Attorney 2** has since recovered $70 million from **Attorney 1** the net (excl. relevant taxes) which has since been paid over to FCJ. As at May 2016, **Attorney 1** still owes an amount of $109.6 million (including interest and penalties of $39.6 million) to FCJ. Since our audit, FCJ has filed a report with the Fraud Squad.

1.12 In December 2011, FCJ engaged the services of **Attorney 1** at a cost of $3.0 million to review the Corporation's Policy and Procedures Manual. The letter of engagement did not indicate the expected delivery date. FCJ advanced the attorney $750,000 on December 22, 2011. However, the attorney did not deliver the draft Policy and Procedures Manual and the service was terminated in September 2012. We saw no evidence that FCJ took the necessary steps to recover the $750,000. FCJ subsequently, engaged a former employee at a cost of $750,000 to review the same Manual.

1.13 FCJ did not present for audit scrutiny, contract agreements setting out the terms and conditions for the engagement of all attorneys engaged, despite our requests. Therefore, we were unable to ascertain the extent to which FCJ would have been protected from contractual breaches and additional expenses.

FCJ paid five Board Members $25 million for operational activities

1.14 **FCJ paid $25 million to five Board members employed in key managerial positions of the company.** The Board relied on the Articles of Association dated October 9, 1987 to engage the five members **(Appendix 1)**. Prior to the decision to engage the members, the Board sought legal opinion from the Company Secretary (an attorney on the Board) who used the Articles of Association to support the Board's action. The provisions of the Articles of Association are however, in conflict with the GoJ's Corporate Governance Framework[4]. Further, Section 6 (1) (a) of the Public Bodies Management and Accountability (PBMA) Act - the legal framework for public bodies requires every board to take the necessary steps to ensure the accountability of all persons who manage the resources of the public body. In one instance, retroactive approval was received from the Ministry of Finance and the Public Service Planning (MOFPS) for one member. We noted that the Company Secretary also benefited from this arrangement. Further, our perusal of the Articles of Association revealed that it does not recognise the reporting responsibility of the Board to the Portfolio Ministry and the MOFPS.



1.15 **In keeping with good corporate governance practices and the PBMA Act, the Board is responsible for the strategic direction of FCJ and the monitoring of the Managing Director's performance**. On the other hand, the Managing Director is accountable to the Board for the p**erformance o**f the FCJ and implementation of the Board's strategies and policies. By virtue of the Board appointing its members to carry out the day to day operations of the Corporation, the process of accountability was compromised and an environment of conflict of interest would have been created.

Issues related to the appointment of the Board Members:

We observed that no contracts were in place outlining the deliverables and duration of the engagements:

i. The Chairman of the Finance Committee was paid $3.4 million from August 2012 to February 2013 to provide oversight to the Finance Department, while still occupying the position of Chairman of that Committee. FCJ cited that this assignment was on the basis of the FY2011/12 Auditor's report which revealed internal control weaknesses.

ii. We were unable to substantiate the basis on which the Company Secretary/Chairman of the Hu**m**an Resource Committee was paid $7.3 million between August 7, 2012 and September 26, 2013 as the engagement letter was not presented for review, despite our requests.

iii. Between August 2012 and June 2013, the Board Chairman and another Member acted as Managing Director in two separate instances for six months and received salaries amounting to $2.7 million and $4.3 million, respectively. We also noted that the Board Chairman presided over the Board meetings during his tenure as acting Managing Director.

[4] Principles 1(4) and 2(10) – The Board should retain full and effective control over the strategic direction of the Public Body while allowing the CEO take full responsibility for its day to day operations.

1.16 FCJ in its response indicated that "the Board took the decision to implement Temporary Management Oversight Team to achieve speedy implementation of the Scrap Metal Trade; obtain first hand information on critical areas and oversee corrective action deemed threatening to the performance of the company". The Corporation also stated "that the outcome of these arrangements was an increase in performance whereby profit moved from $329 million at end of 2010 to $627 million at the end of 2015". However, our review of the audited financial statements (**Section 2 para. 2.0 to 2.2**) revealed that the reported profit of $627 million at end 2014/15 was primarily the result of valuation adjustments.

FCJ paid two consultants $15.2 million for lack of technical capability

1.17 FCJ indicated that the Finance and Human Resource Units do not possess the necessary competencies and skills to perform the specified tasks. We found no evidence that FCJ did all that it reasonably could to strengthen capacity in these areas despite FCJ's stated human resource concerns. Instead, FCJ engaged two Consultants and paid a total of $15.2 million during the period December 2011 to October 2015 to perform operational tasks in the Human Resource and Accounting units as outlined in **Appendix 2**. Our review of the Board minutes revealed that the Board was concerned with the performance of a senior officer who was engaged on a contract. However, FCJ extended the contract of the senior officer three times since 2012. Subsequent to the extension of the contracts, FCJ engaged a consultant to perform tasks that this senior officer should have carried out.

1.18 FCJ in its response to our draft report indicated that during the 2013/14 financial audit, the External Auditor expressed concerns with the state of the accounts receivable that would have resulted in the qualification of their report. Consequently, the Corporation engaged the consultant to bring the accounts up to date. However, up to the time of reporting the consultant was still engaged to provide services such as preparation of financial statements and reconciliation of GCT on receivables. We found no evidence that staff in the Units were trained to perform these tasks.

1.19 FCJ experienced a high turnover in the post of Managing Director. Since July 2012, the Managing Director with the longest tenure served for only 1 year and 5 months, while three managing directors served for less than one year (**Figure 2**). In this regard, the high turnover of the key management staff may have negatively impacted FCJ's institutional capacity.

Figure 2 Tenure of Managing Directors for the Period 2010 to 2015

	MD1	MD2	MD3	MD4	MD5	MD6
No. of Months	32	6	6	10	17	2

Source: **AuGD review of FCJ records**

FCJ did not appoint a Procurement Committee

1.20 We noted that FCJ did not appoint a procurement committee; such a committee would ensure compliance with GOJ's procurement guidelines aimed at promoting the principles of openness and transparency. We found that the Heads of Departments, responsible for procuring goods and services for their units, submitted requests for purchases to a committee (PDM) of the Board for endorsement and subsequent approval by the Board.

1.21 FCJ subsequently indicated that the "PDM Committee played the role of the procurement committee." However, we noted that the five members of the Committee were also serving as FCJ board members; this is in breach of Section 6(A) of the PBMA Act.

1.22 FCJ did not faithfully comply with Government guidelines which require purchase orders to be prepared for all goods and services, whether payment is by cash or credit, and that these should be attached to the supplier's invoices for payment. We found that purchase orders were not prepared for goods and services purchased, totalling $3.5 million from nine contractors. FCJ explained that purchase orders are only prepared for credit transactions and not cash transactions. This practice however, limits the audit trail over the Corporation's acquisition of goods and services thereby exposing FCJ to irregularities.

FCJ did not provide evidence that a fleet vehicle was used for the intended purpose

1.23 We observed that FCJ's management of the fleet vehicles was not in accordance with GOJ's Comprehensive Motor Vehicle Policy, underscoring the lack of adequate monitoring systems for use of the entity's resources. FCJ purchased a vehicle in May 2014 for $6.7 million to be utilized as a pool vehicle to facilitate tours with investors and long distance travel by staff. However, FCJ did not maintain the prescribed log book for the use of this vehicle; therefore, we could not verify whether the vehicle was used for the intended purpose. We observed from the August

2014 Board minutes, where a member of the Board questioned the Chairman regarding his operation of the vehicle between May 2014 and August 2014. FCJ's records revealed that the vehicle was subsequently assigned to the Portfolio Minister from September 2014. However, we found no evidence that the requisite approval was obtained from the Financial Secretary for re-assignment of the vehicle.

1.24 Further, we observed that another vehicle owned by FCJ was parked at the Chairman's office. FCJ indicated that this was due to the unavailability of a 24 hour secure parking space on the Company's premises.

Delayed implementation of three development projects

1.25 FCJ surpassed its target by seven per cent in achieving a 90 percent occupancy rate for the factory spaces available for lease. However, the entity was not successful in developing 1.3 million square feet of factory space on three sites: Caymanas, Naggo Head and Garmex Freezone[5] **(Figure 3)**.

Figure 3 Projects for Development

No.	Project	Cabinet Approval	Proposed commencement	Status	Expenditure to date ($million)
1	Caymanas Economic Zone	January 21, 2011	Not Known	Not started	190.2
2	Naggo Head	Not provided	FY 2010/11	Started	64.0
3	Garmex Industrial	Not Provided	FY 2009/10	Not started	25.3
	Total				**279.50**

Source: **AuGD review of FCJ records**

Development of the Caymanas Economic Zone

1.26 In January 2011, Cabinet approved the development of 200 acres of land as part of the Caymanas Economic Zone (CEZ) initiative. The CEZ forms part of the GOJ's Global Logistics Hub initiative, conceptualized in 2008. The development was to facilitate the construction of roads, drainage, landscaping, and sub-division of lots; a 25,000 sq. ft. building to host FCJ's Corporate office and an additional 100,000 square feet of building space. In September 2014, Cabinet assigned oversight responsibilities for the CEZ initiative to the Caymanas Special Economic Zone Enterprise Team. Since conceptualisation, FCJ incurred expenditure of approximately $190.2 million from which no benefit has been received (Appendix 3).

Development of the Naggo Head Information and Communications Technology (ICT) project

1.27 FCJ should have commenced development of 100,000 square feet of factory space in Naggo Head in FY 2010/11. Since then FCJ has incurred expenditure of $25.3 million. FCJ subsequently indicated that a joint venture agreement was approved by Cabinet on January 11, 2016 and infrastructure work has since commenced.

[5] 2016/17 Corporate Plan

Redevelopment of Garmex Free Zone and Commercial Complex

1.28 In 2009, FCJ earmarked the Garmex Free Zone and Commercial Complex for redevelopment as a part of the Logistic Hub Initiative. The redevelopment plan included the redesign of three existing buildings and entrance; construction of a new administrative building; multi-level parking garage and three (3) industrial buildings totalling 120,000 square feet of factory space. FCJ incurred expenditure totalling $64.0 million in 2009 for tender documents and technical designs.

1.29 FCJ indicated that the delays in developing the projects were as a result of the change in Portfolio Ministers; funding that was required; GOJ's instruction that no additional debt was to be incurred under the new IMF agreement as well as, the pending decisions from both Cabinet and the CEZ Special Enterprise Team, since 2013. FCJ neither provided documentary evidence of this instruction nor did the Board minutes reflect any discussion by board members regarding the constraints being experienced. Further, for projects of this magnitude which were highly dependent on external factors, we would have expected FCJ to develop and implement risk mitigating strategies. We saw no evidence of such strategies or that the parent Ministry provided monitoring and oversight for the planned developments.

11.58 acres of prime commercial land sold to a Private Trust at a nominal price

1.30 We noted that Cabinet approved FCJ's transfer of 11.58 acres of commercial land valued at $164 million[6] to a private trust for $10,000. The Cabinet Decision indicated that the beneficiary of the Trust is the Community; however, we noted that the Directors of the Trust were three private individuals. The Trust was not registered with the Registrar General's Department or the Department of Co-Operative and Friendly Societies; hence we were unable to obtain a copy of the Trust Deed to validate the beneficiary of the Trust. Further, we noted that the title did not include a restrictive caveat to prevent the unauthorised disposal of the property in whole or in part. Consequently, we were unable to determine the terms and conditions governing the transfer.

[6] Book Value

Section Two

Financial Statements Assessment

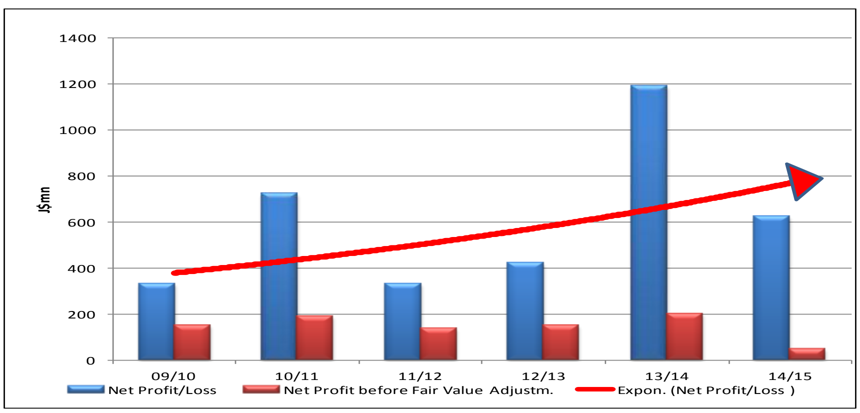
Disclaimer

The Financial Statements Assessment is solely an analytical review of the audited financial statements of the Factories Corporation of Jamaica (FCJ) and not a test of the management's assertions regarding the figures in the financial statements and disclosures. The calculation of ratios was merely intended to provide trend analyses of key financial items in the annual audited balance sheets and income statements for FY2009/10 to FY2014/15. Annual reports and other supplementary information were also used in the analytical process.

Net Profit Margin

2.0 FCJ's profit position, although positive over the review period, was significantly influenced by fair value adjustments to investment properties, with the fair value being the entity's estimate of market price[7]. The net profit margin ratio rose to a high of 2.36 in FY2013/14 from 0.83 in FY2009/10, before falling to 1.09 in FY2014/15 (despite accounting for net loss on disposal of investment properties and impairment). Excluding fair value adjustments, net profit margin declined to 0.07 at end FY2014/15 from 0.09 in FY2009/10 after peaking at 0.39 in FY2013/14 **(Appendix 5 Table 1).**

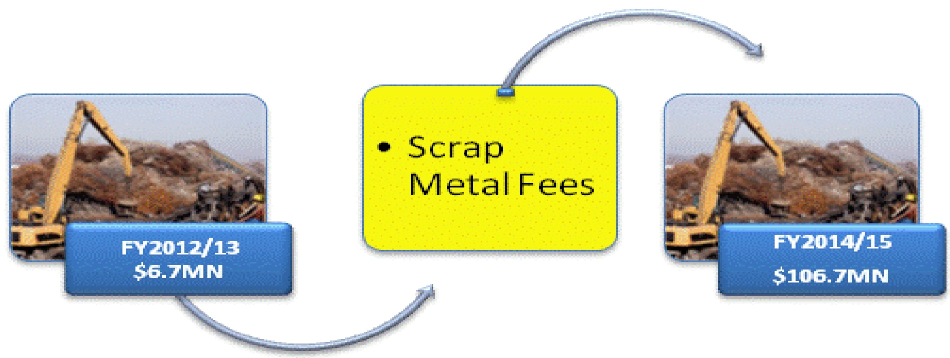
Chart 1 Profit Trend FY2009/10- FY2014/15



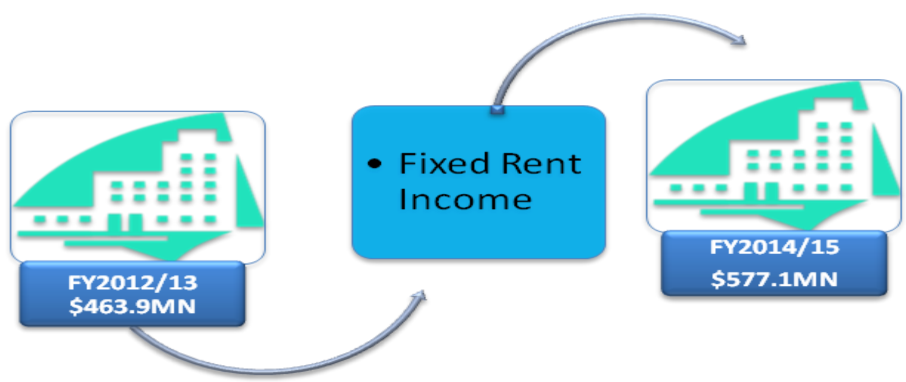
Source: AuGD analysis of FCJ audited financial statements

[7] FCJ stated that the fair value of the completed investment properties has been arrived at on the basis of valuations carried out by qualified internal and external valuators using standard valuation methodologies including the use of prior year valuations.

2.1 Net profit margin rose in FY2013/14 significantly influenced by a 266.7 per cent increase in fair value adjustment for investment properties, which boosted net profit to $1.2 billion from $420.2 million in FY2012/13. Net profit fell to $627.0 million in FY2014/15 but was improved relative to the $329.0 million recorded for FY2009/10 (**Chart 1**). For FY2014/15, whereas rental income increased by 14.4 per cent, expenses (excluding scrap metal expenses) rose by 18.8 per cent to $396.5 million relative to the previous year. The increase in expenses was driven mainly by 137.1 per cent increase in repairs and maintenance costs. Relative to FY2009/10, rental income grew by 44.8 per cent to $577.1 million, while total expenses (excluding scrap metal expenses) increased over the period by 43.5 per cent **(Appendix 5 Table 2)**.



2.2 **FCJ's total income fell by $107.3 million or 16.9 per cent to $527.9 million in FY2014/15 relative to the previous year due to the negative impact of an adjustment for impairment ($49.1 million) and net loss on disposal of investment property ($167.0 million).** The latter was primarily related to the transfer of 11.58 acres to a private trust (Secton 1, para. 1.30). We noted that over the review period, fair value adjustment consistently exceeded net profit before taxation suggesting that the entity's underlying performance was not materially driven by core activities.



Return on Assets

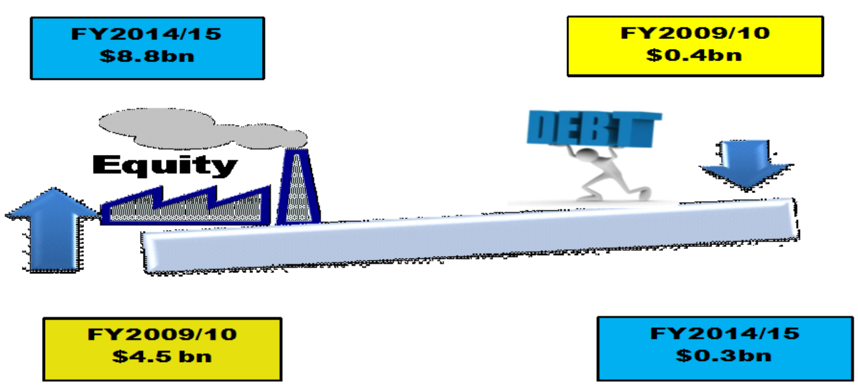
2.3 **FCJ's return on assets fluctuated over the six-year review period and averaged 0.08 implying that in general, only $0.08 of net income was generated from every dollar of assets invested by the Corporation[8].** Excluding fair value adjustment, FCJ's return on assets averaged only 0.01 over the review period, further underscoring inefficient use of assets to generate profit from core activities. The ratio of 0.14 for FY2013/14, the highest over the period, was underpinned by the fair value adjustment, which was also the highest for the assessment period.

Debt and Solvency

2.4 **FCJ's debt to total assets ratio fell to 0.06 for FY2014/15 from 0.23 for FY2009/10, suggesting a decline in the level of financial risk over the six-year review period (Appendix 5 Table 3).** The relatively low ratio was reflective of FCJ's asset holdings valued at $7.6 billion on average compared to average total liabilities of $694.8 million. Total assets grew by 59.6 per cent to $9.4 billion in FY2014/15 from $5.9 billion in FY2009/10. However, the growth in assets was not influenced by acquisitions but by the cumulative valuation adjustments amounting to $3.1 billion in respect of investment properties. On the other hand, there was a 57.7 per cent fall in liabilities to $580.0 million in FY 2014/15 from $1.4 billion in FY 2009/10.

2.5 The decline in FCJ's liabilities reflected a 75.9 per cent contraction in long-term liabilities underpinned by elimination of deferred tax and a reduction in long-term debt obligations to the National Insurance Fund (18.9 per cent). In contrast, short-term obligations rose by 38.5 per cent due to growth of 114.8 per cent in Trade and Other Payables. Against this background, the reduction in the ratio indicated that FCJ became less dependent on leverage (borrowings) and would require a smaller portion of assets to pay off its liabilities in the event of liquidation.

Trends in Debt and Equity: FY2009/10 to FY2014/15



[8] The return on assets ratio indicates how well management is employing the company's total assets to make a profit. The higher the return, the more efficient management is in utilizing its asset base.

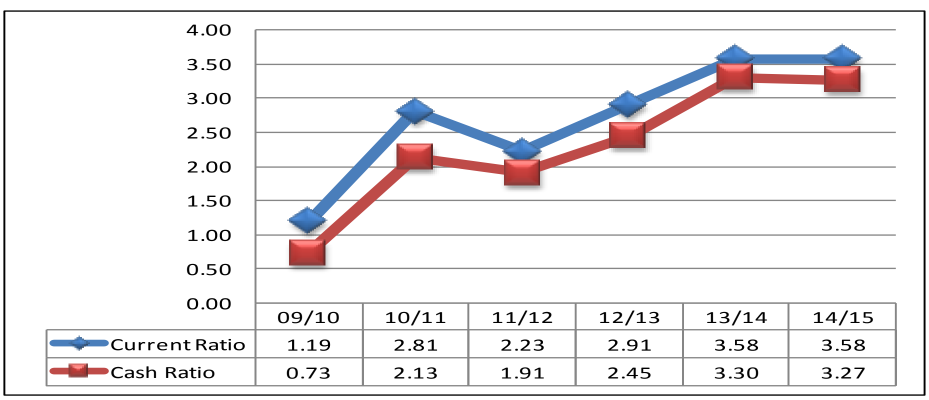
2.6 Notably, the low debt ratios also suggest a strong equity position over the review period, corroborated by the debt to equity ratio which measures the debt component of FCJ's capital base. The debt ratio showed that financing from creditors comprised only 6.0 per cent of FCJ's capital structure at end FY2014/15, down from 23.0 per cent at end FY2009/10. This confirms significantly greater use of equity financing relative to debt financing[9].

2.7 **FCJ was able to meet interest payments on outstanding debt over the period FY2009/10 to FY2014/15.** FCJ's interest coverage ratio (including fair value adjustment) reflected a trend improvement over the review period to 26.6 times in FY2014/15 from its lowest point of 13.6 times in FY2009/10. This was reflected in growth of 36.2 per cent in FCJ's earnings before interest and taxes (EBIT) coupled with a decline in interest payments of 30.4 per cent due to the falling stock of outstanding debt. However, when fair value adjustment is excluded to expose only the cash component, interest cover was significantly lower averaging 5.9 times for the review period. For FY2014/15 interest cover (excluding fair value adjustment) was 2.7 times relative to 8.5 times for the previous year and 5.2 times for FY2009/10 (**Appendix 5 Table 3**).

Liquidity

2.8 **FCJ maintained a strong liquidity position over the six-year review period as short-term resources were adequate to cover near-term liabilities.** This was evident in the current ratio which measures the ability to repay current liabilities (short-term debt and other obligations) with liquid assets. FCJ's current assets coverage of current liabilities was 3.6 times for FY2014/15, similar to that for FY2013/14 but represented an increase relative to 1.2 for FY2009/10[10] (**Chart 2**). FCJ's improved liquidity position in FY2014/15 relative to FY2009/10 reflected 316.5 per cent growth in current assets to $1.1 billion, outpacing the 38.5 per cent increase in current liabilities to $302.0 million. The expansion in current assets was underpinned by 517.9 per cent growth in cash and bank balances held by FCJ, while current liabilities were driven mainly by a 114.8 per cent increase in Trade and Other Payables.

Chart 2 Liquidity Ratios – FY2009/10 to FY2014/15



Source: AuGD analysis of FCJ audited financial statements

[9] Notably, the debt ratio was well below the acceptable ceiling of 2.5 required for commercial entity certification under the Financial Administration and Audit (FAA) Act.

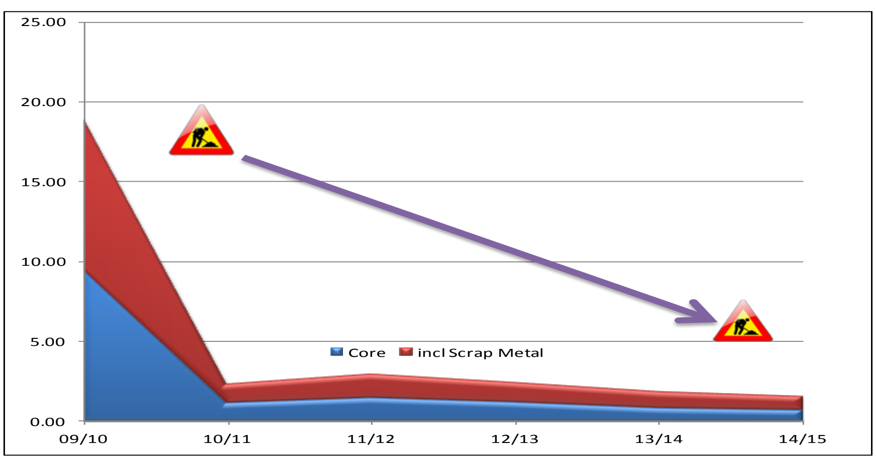
[10] The current ratios generally exceeded the acceptable level of 1.2 required for commercial entity certification under the FAA Act.

2.9 Of note, cash and bank balances accounted for 91.1 per cent of current assets in FY2014/15 up from 61.4 per cent for FY2009/10. Similarly, trade and other payables reflected the larger share of current liabilities averaging 64.6 per cent over the review period. Short-term debt on average accounted for 34.7 per cent of current liabilities. The decline in the liquidity ratio in FY2011/12, relative to the previous year largely resulted from a 62.3 per cent reduction in trade and other receivables and a 4.3 per cent decline in cash and bank balances. Trade and other receivables subsequently grew by 74.6 per cent while, cash and bank balances increased by 150.5 per cent between FY2011/12 and FY2014/15.

Working Capital Turnover

2.10 **FCJ's working capital turnover ratio declined over the review period to 0.74 at end-FY2014/15 (0.88 inclusive of scrap metal income) from 9.53 in FY2009/10** [11] (**Chart 3**). The fall in the ratio indicated that FCJ did not use its working capital efficiently to generate income since FY2009/10. Whereas working capital increased by 1,766.3 per cent over the six year review period and by 107.5 per cent since FY2012/13, income from core operations (rental income) grew by 44.8 per cent and 24.4 per cent over the respective periods. Inclusive of scrap metal (non-core) which was incorporated in FCJ's activities in FY2012/13, income (rental plus scrap metal income) grew by 45.3 per cent over the three year period ended FY2014/15. In other words, the significant improvement in working capital did not engender a proportionate increase in revenue over the review period.

Chart 3 Working Capital Trend FY2009/10 to FY2014/15



Source: AuGD analysis of FCJ audited financial statements

[11] Of note, under the FAA Act, the positive working capital ratio of a public body to be certified as a commercial entity should be at least 1.2.

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Appendices

Appendix 1 Board Members Engaged in Daily Activities

Members	Position	Employed as	Period	Amount Paid ($)
Board member 1	Director	Managing Director	August 2, 2012 to January 15, 2013	4,261,021.72
Board Member 2	Chairman	Managing Director	January 16, 2013 to June 30, 2013	2,652,741.39
Board Member 3	Company Secretary/HR Committee Chairman	Company Secretary (Paid)	August 7, 2012 to September 26, 2013	7,324,359.14
Board Member 4	Director/Finance Committee Chairman	Provide oversight to Finance Department	August 7, 2012 to February 28, 2013	3,427,626.81
Board Member 5	Director	Logistic Consultant	August 7, 2012 to September 30, 2013	7,390,701.09
			Total	**25,056,450.15**

Source: FCJ records

Appendix 2 Payments to consultants

Consultant	Tasks	Period	Amount Paid ($)
Consultant 1 Human - Resource Management	• Calculate salaries and allowance; prepare detail schedules • Calculate incentive payments to staff • Calculate performance measure and performance levels • Review FCJ Pension Plan Trust Deed and Plan Rules • Give overview of pension plan to staff members • Draft letter to former staff member regarding unclaimed benefit • Draft letter reminding Employee Administrator Ltd that the actuarial valuation will become due • Review of existing policies and procedures manual	**Sept 2011 to Dec 2013**	2,403,000.00
Consultant 2 - Finance	• Preparation of Financial Statements • Prepare reconciliation of GCT on receivables • Transfer of knowledge to new Internal Auditor re reconciliation of GCT on receivables • Evaluation of financial proposals of companies that tendered for the construction and management of the Naggo Head Technological Park	**Mar 2014 to Oct 2015**	12,829,250.00
			15,232,250.00

Source: FCJ records

Appendix 3 Expenditure on Caymanas Economic Zone

Date	Payee	Particulars	Funds Paid ($)
	Urban Development Corporation (UDC)	10% Deposit on Land (incl. Stamp duty)	90,100,000.00
May 2011/ Aug 2011	Payee 2	Legal fees re Purchase of 200 acres of Land from UDC	26,437,500.00
Dec 2014 Jul 2015	Payee 3	Legal Fees re Purchase of 200 acres of Land	17,000,000.00
Jun 2011 Jul 2011 Nov 2011 Dec 2011 Mar 2012	Payee 4	Technical Consultancy – Contract Documents for Office Building & Civil Works re Phase 1 of the Caymanas Economic Zone	51,532,096.46
Sep 2013	Payee 5	Legal Fees pertaining to Risk Analysis & Allocation of risk for Phase 1 of Caymanas Economic Zone – US$50,000	5,082,085.00
TOTAL			**190,151,681.46**

Source: FCJ records

Appendix 4 Calculation of Financial Ratios

Activity Ratios

Working Capital Turnover ratio – refers to the ratio of sales to working capital (current assets less current liabilities). This measures the company's efficiency in its use of working capital.

$$Formula = \frac{Sales}{Working\ Capital}$$

Liquidity Ratios

Cash Ratio – refers to the ratio of cash and cash equivalents to current liabilities and measures an entity's ability to pay off its current liabilities with only cash and cash equivalents.

$$Formula\ = \frac{Cash + Cash\ equivalents}{Current\ Liabilities}$$

Current Ratio - refers to the ratio of current assets to current liabilities and indicates an entity's ability to meet current liabilities with its current assets.

$$Formula\ = \frac{Current\ Assets}{Current\ Liabilities}$$

Debt and Solvency Ratios

Debt-to-Assets (Debt Ratio) – refers to the ratio of an entity's debt to total assets and measures the proportion of assets that are financed with debt.

$$Formula = \frac{Total\ Liabilities}{Total\ Assets}$$

Debt-to-Equity – refers to the ratio of an entity's debt to total equity and indicates the relative use of debt and equity as sources of capital to finance the entity's assets.

$$Formula = \frac{Total\ Liabilities}{Total\ Equity}$$

Times Interest Earned/Interest Cover – this ratio compares the earnings available to meet interest obligations with the interest obligation.

$$Formula\ = \frac{Earnings\ before\ Interest\ \&\ Taxes\ (EBIT)}{Interest\ Expense} \quad = \frac{Net\ Income + Interest\ Expense + Taxes}{Interest\ Expense}$$

Profitability Ratios

Net Profit Margin – refers to the ratio of an entity's net income to sales and measures how much of each dollar of sales is left over after all expenses.

$$Formula\ = \frac{Net\ Income}{Sales}$$

Rate of Return on Assets – refers to the ratio of net income to total assets. This indicates the amount earned on each dollar of assets.

$$Formula\ = \frac{Net\ Income}{Total\ Assets}$$

Appendix 5 Table 1 – 3

Table 1: Profitability and Return Ratios

Indicator	2014/15	2013/14	2012/13	2011/12	2010/11	2009/10
Net Profit Margin	1.09	2.36	0.91	0.87	1.73	0.83
Return on Assets (ROA)	0.07	0.14	0.06	0.05	0.11	0.06
Return on Equity (ROE)	0.07	0.14	0.06	0.05	0.12	0.07
Net Profit Margin_adjusted	0.07	0.39	0.32	0.24	0.08	0.09

Source: AuGD's Computations; net profit margin _adjusted for fair value

Table 2: FCJ Income Statement Extract

J$M	2014/15	2013/14	2012/13	2011/12	2010/11	2009/10
Income:						
Fixed Rent	577.11	504.50	463.98	380.45	416.88	398.65
Total Income*	**527.91**	**635.22**	**523.51**	**427.63**	**449.19**	**425.00**
Total Expenses	**481.37**	**433.90**	**372.81**	**291.05**	**259.20**	**276.35**
Net Profit before Fair Value Adjustm.	**46.54**	**201.31**	**150.70**	**136.58**	**189.99**	**148.65**
Fair Value Adjustment	584.89	994.77	271.25	240.84	688.49	294.42
Net Profit/Loss	**627.01**	**1,190.51**	**420.23**	**331.52**	**722.57**	**329.00**

Source: FCJ Financial Statements
*Reflect impact of net loss on disposal and impairment of investment properties for FY2014/15

Table 3: Debt and Solvency Ratios – FY2009/10 to FY2014/15

	2014/15	2013/14	2012/13	2011/12	2010/11	2009/10
Debt Ratio	0.06	0.06	0.07	0.08	0.10	0.23
Debt to Equity Ratio	0.07	0.06	0.07	0.08	0.11	0.30
Interest Cover Ratio	26.60	46.85	16.28	14.52	26.50	13.60
Interest Cover Ratio (Excluding FVA)	2.72	8.54	6.42	5.89	6.52	5.23

Source: FCJ Financial Statements