State Pharmaceuticals Corporation of Sri Lanka - 2014

The audit of financial statements of the State Pharmaceuticals Corporation of Sri Lanka for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 and the income statement, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 29 of the State Industrial Corporations Act, No. 49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14(2)(c) of the Finance Act appear in this report.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards consistent with International Auditing Standards of Supreme Audit Institutions (ISSAI 1000 – 1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

1.4 Basis for Disclaimer of Opinion

As a result of the matters described in paragraph 2.2 of this report, I am unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded items and the elements making up the statement of financial position, statement of comprehensive income, statement of changes in equity and cash flow statement.

2. Financial Statements

2.1 Disclaimer of Opinion

Because of the significance of the matters described in paragraph 2.2 of this report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

The employees pensions benefits liability had not been valued by an Actuarial Valuer in terms of Sri Lanka Accounting Standard No. 19 and a Fund had not been established for the provisions made for employees gratuity.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) A sum of Rs.2,973 relating to the year under review included in the interest income had been understated and a sum of Rs.1,376,490 relating to the ensuing year had been included in the interest income shown in the financial statements. As such, the interest income on investment and the value of other debtors had been overstated by Rs.1,373,517 and Rs.1,376,490 respectively.

(b) The stock of drugs had been understated by Rs.49,572 and stationery and stocks in transit had been overstated by Rs.240,750 and Rs.2,289,580 respectively as at 31 December of the year under review.

(c) A stock of equipments belonging to the Corporation had been handed over to the Army in November 2014. However, no action had been taken to identify the cost and acccumulated depreciation relating thereto and eliminate from the accounts.

(d) The value of container deposits and the Value Added Tax payable had been overstated by Rs.739,661 and Rs.566,982 respectively and the value of clearance expenditure had been understated by Rs.172,679 in the financial statements due to a classification error.

(e) In the computation of the value of sales of drugs issued for the Medical Supplies Division, a sum of Rs.29,103,838 relating to the year under review had not been included in the sales of the year due to non-issuing of debit notes during the year itself relating to customs duty which should be included as the cost. Moreover, a sum of Rs.342,728,037 relating to the year 2013 and preceding years had been shown as sales of the year under review. As such, the value of sales shown in the financial statements had been overstated by Rs.313,624,199. However, action had been taken to issue debit notes relating to customs duty during the year itself from June 2014.

(f) Even though it had been computed that a damage valued at Rs.30,037,288 had occurred to the Corporation due to a fire that broke out in the ground floor of the Corporation on 6 September 2014, action had not been taken to disclose or make necessary adjustments thereon in the financial statements.

2.2.3 Accounts Receivable and Payable

The following observations are made.

(a) According to the financial statements presented, the total Trade Debtors balance of the Corporation as at 31 December 2014 amounted to Rs.3,782,708,920 out of which, 92.89 per cent or Rs.3,513,842,086 had been debts receivable from the Government and the Semi – Government Institutions. Further, out of those Trade Debtors, a sum of Rs.3,082,188,947 or 81.84 per cent had been due from the Medical Supplies Division and out of that, the total loan balances older than 05 years amounted to Rs.604,962,927. The age analysis relating to the balance value had not been made available to audit due to non-reconciliation of the Medical Supplies Division with the debtors balance.

(b) Even though the cash should be settled within 30 days to 45 days for sales on credit according to the policy of the Corporation, out of the balance of Rs.700,519,973 receivable from the private, Government and Semi-Government institutions except the Medical Supplies Division, the debtors balance older than one year and 05 years amounted to Rs.20,024,110 and Rs.12,380,842 respectively.

(c) The value of drugs amounting to Rs.867,080,605 of which the payments had been rejected by the Medical Supplies Division relating to the period from the year 2003 to 31 December of the year under review, could not be reimbursed from the relevant supplier.

(d) The container deposits totalling Rs.4,825,500 recoverable from the year 2007 to the year 2013 had not been recovered even by May 2015.

(e) Out of the insurance claims for the stocks of damaged drugs totalling Rs.11,121,578 relating to the period from the year 2003 to the year under review, it was observed in audit that there was an uncertainty in recovering balances totalling Rs.5,041,314 relating to the preceding years. This situation had arisen due to failure in identification and settlement of old receivable balances existing in the Insurance Claim Account.

2.2.4 Lack of Evidence for Audit

The evidence relating to the confirmation of the debtors balances totalling Rs.54,454,036 of 262 trade debtors and Rs.3,082,188,947 of the Medical Supplies Division and creditors balance totalling Rs.272,751,718 of 160 trade creditors had not been made available to audit.

2.3 Non-compliance with Laws, Rules and Regulations

A Register of Fixed Assets had not been maintained in terms of the Treasury Circular No.842 of 19 December 1978.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Corporation for the year ended 31 December 2014 had resulted in a net profit of Rs.741,553,839 as compared with the corresponding net profit of Rs.762,992,143 for the preceding year thus indicating a decrease of Rs.21,438,304 in the net profit of the year under review as compared with the preceding year. The increase in donations by 143 per cent, overdraft interest by 10713 per cent, foreign travel expenses by 240 per cent and initial expenses by 115 per cent had specially attributed to this decrease.

3.2 Legal Action instituted against or by the Corporation

External institutions and officers had filed 04 cases in the Courts against the Corporation in connection with the breach of fundamental rights relating to award of Tenders, demotion from post and blacklisting etc. The compensation claimed in that connection amounted to U.S.$ 948,759. The Corporation had filed 03 cases in the Courts against 03 external institutions claiming compensation totalling Rs.7,140,696.

4. Operating Review

4.1 Operating Inefficiencies

The following observations are made.

(a) It was observed at the audit test check carried out in respect of purchase of drugs that a total of Rs.118,268,280 should have been recovered from suppliers by 31 December of the year under review for drugs rejected due to supply of substandard drugs relating to Indent Nos. DHS/(c)SU/172/194K/08-09, DHS/SU/180/974JP/08-09,DHS/MG/221/12, DHS/SN/153/2014,DHS/RMT/55/2014DHS/LWW/001/049/MBD/2012, DHS/JA/320/2010, DHS/SKW/62/5/2011, DHS/P6/49/2012, DHS/SH/89/2010.

(b) A sum of Rs.3,601,920 as rent for stores and a sum of Rs.9,539,227 as expenses on destruction of stocks had been paid in the year under review for 02 buildings taken on rent for storing expired drugs and surgical equipments with problematic labels. It was observed in audit that these expenses had to be incurred due to lapse of a long period for disposal of expired stocks.

(c) The Corporation had failed to supply 332.02 million units of 103 items of drugs ordered for the year under review by the Medical Supplies Division out of which, the quantity not supplied in respect of 38 items of drugs for which no supplies whatsoever had been made, amounted to 38.96 million units.

(d) The Corporation had obtained Bank overdrafts facility and as such, the overdraft interest incurred in the year under review amounted to Rs.328,659,292. Even though these overdraft interest incurred from the year 2012 to April 2014 had been reimbursed by the General Treasury, that reimbursement had been stopped from May 2014. As such, the Corporation had to incur the total interest on overdraft from May of the year under review. As a result, out of the expenditure on overdraft interest of the year under review, a sum of Rs.149,658,755 had to be incurred by the Corporation and that was an increase of 10,713 per cent as compared with the preceding year. Had the Corporation incurred the total expenditure on overdraft interest amounting to Rs.328,659,292 for the year under review, it was observed in audit that the pre-tax profit of the year under review would have decreased up to Rs.562,553,302.

(e) A stock of 12,700 Tender documents books had existed in the stores as at 31 December 2014 and a large amount of that stock had become unusable due to revision of Conditions of Tenders by the Corporation. Those stocks had existed due to printing of a large number of books at once exceeding the requirement and the value of the unusable books had not been made available to audit.

(f) According to the age analysis of Goods in Transition Account, stocks valued at Rs.166,748,920 existed as stocks in transit for over a period of six months and out of that, stocks valued at Rs.39,669,119 existed as stocks in transit for over a period of one year. It was observed in audit that those stocks existed as stocks in transit due to delay in issuing relevant debit notes.

(g) The value of provisions for doubtful debts amounted to Rs.523,933,159 and it was an increase of 28.49 per cent as compared with the preceding year. Provisions for doubtful debts valued at Rs.135,196,742 existing for over a period of 10 years included in the debtors balance of the Medical Supplies Division had been made in the year under review and recovery of these debts was at a weak level.

(h) The particulars of the activities of Osusala Outlets during the year under review and the 04 preceding years were as follows.

	2014	**2013**	**2012**	**2011**	**2010**
Number of Osusala Outlets in operation	33	31	28	25	25
Turnover Rs. Millions	2,594.3	2,360.2	2,185.9	1,974.8	1,840.2

Purchases – Local, Rs.Million	1,355.9	1,246.9	1,189.8	963.3	918.7
Purchases – Imported, Rs.Million	844.8	729.3	718.4	678.8	683.7
Profit Earned - Rs.Million	113.8	110.9	134.1	102.6	96.6
Number of Osusala Outlets Incurred Losses	23	15	10	09	06
Loss Incurred –Rs.Million	41.9	20.7	8.1	7.2	7.0

The following observations are made.

(i) The corporation had 33 Osusala Outlets including the 03 newly opened outlets during the year under review and 23 Osusala Outlets had sustained losses totalling Rs.41,958,679 and 10 Osusala Outlets had earned profits of Rs.113,887,183. As such, the entire operation of Osusala Outlets had earned net profits of Rs.71,928,504 and as compared with the profit of Rs.90,288,620 received in the preceding year, it was a decrease of Rs.18,360,116 representing 20.3 per cent.

(ii) The Osusala Outlets at Avissawella, Hambanthota, Ampara, Karapitiya, Jaffna, Polonnaruwa and Piliyandala had sustained losses amounting to Rs.6,233,818 and Rs.11,647,708 continuously in the years 2012 and 2013 respectively. The loss of Rs.12,959,025 sustained by those 07 Osusala Outlets in the year under review represented 30.88 per cent of the overall loss sustained in the year under review and that was an increase of 11.3 per cent than the loss sustained in the year 2013.

(iii) Nugegoda Osusala Outlet which had been maintained with a profit margin less than even one per cent since the year 2011, had sustained losses amounting to Rs.2,186,964, which was 3 per cent in the year under review. In addition, even though the Osusala Outlets at Rathnapura, Panadura, Galle and Badulla had earned profits of 5.15 per cent, 0.72 per cent, 1.74 per cent and 0.47 per cent respectively in the year 2013, losses of 2.6 per cent, 6.3 per cent, 1.4 per cent and 1.4 per cent had been sustained by those outlets in the year under review.

(iv) The Osusala Outlet at Colombo 01 had granted credit facilities amounting to Rs.17,702,791 to 07 debtors exceeding the approved credit limits.

4.4 Identified Losses

The following observations are made.

(a) The Corporation had sustained a loss of Rs.30,037,288 due to a fire that broke out in the ground floor of the Corporation on 06 September 2014 and the responsible party thereon had not been identified up to the date of audit. Moreover, the insurance institution had agreed to pay an advance of Rs.3,000,000 for that loss.

(b) The Corporation had sustained a loss of stock valued at Rs.62,885,911 in the year under review including drugs valued at Rs.20,591,727 imported for sale of the

Corporation and the drugs valued at Rs.42,294,184 imported for sale of the Medical Supplies Division due to reasons such as failure in quality test and expiration of drugs.

(c) Out of the drugs imported by the Corporation from the year 1996 to the year under year review, drugs valued at Rs.198,999,856 had become unsaleable. The value of the above stock according to the stock verification reports amounted to Rs.134,392,373, thus indicating a difference of Rs.64,607,483. Out of that difference, explanations for the values of Rs.27,851,453 had been made available to audit and a further difference of Rs.36,756,030 existed. As such, the possibility of unsuitable stocks reaching the market again due to the physical non-existence of damaged drugs cannot be ruled out in audit.

4.5 Personnel Administration

The following observations are made.

(a) The approved cadre as at 31 December 2014 had been 970, comprising 127 in executive grades, 621 in non-executive grades and 222 in minor grades and the total vacancies as at that date amounted to 116 comprising vacancies in 09 executive grades, 88 in non-executive grades and 19 in minor grades.

(b) Four officers of the Corporation had been appointed on acting basis for periods ranging from 01 year to 05 years contrary to paragraph 13 of Chapter II of the Establishments Code of the Democratic Socialist Republic of Sri Lanka - 2013.

5. Accountability and Good Governance

5.1 Action Plan

In the examination of the progress in respect of fulfilling the activities included in the Action Plan, 03 activities of the Marketing Division, one activity of the Technical Laboratories and Production Division and one activity of the Human Resources Division had not been fulfilled as at the end of the year under review.

5.2 Budgetary Control

Variances ranging from 12 per cent to 75 per cent were observed between the budgeted income and expenditure and the actual income and expenditure for the year under review thus indicating that the budget had not been made use of as an effective instrument of management control.

6. <u>Systems and Controls</u>

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Corporation from time to time. Special attention is needed in respect of the following weaknesses in the areas of control.

(a) Fixed Assets Control
(b) Stock Control
(c) Debtors and Creditors Control
(d) Procurements
(e) Human Resources Management
(f) Budgetary Control