State Pharmaceuticals Corporation of Sri Lanka - 2015

The audit of financial statements of the State Pharmaceuticals Corporation of Sri Lanka for the year ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 and the comprehensive 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 Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Audit Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Pharmaceuticals Corporation of Sri Lanka as at 31 December 2015 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

Even though it had been encouraged to make an investment plan in respect of the Retirement Benefit Obligation to minimize the possible risk of future liabilities in terms of Sri Lanka Accounting Standard 19, action had not been so taken.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) Sales amounting to Rs.2,273,472 relating to the preceding year had been identified as sales of the year under review.

(b) Value of debit notes issued for recovery of the cost of quality failed drugs purchased for the Medical Supplies Division and other various charges from the relevant suppliers had been brought to account on cash basis instead of accounting for on accrual basis. As such, a sum of Rs.288,401,175 recoverable as at 31 December of the year under review from suppliers had been omitted from accounts.

(c) Even though the cost of quality failed and validity expired drugs purchased in the year under review for the sale of the Corporation and various charges thereon amounting to Rs.51,276,084 should be recovered from suppliers, contrary to that, it had been written off against the profit.

(d) Even though the pre shipment sample checking expenditure of drugs should be recovered from suppliers, a sum of Rs.1,825,267 spent thereon during the year under review had been brought to account as an expenditure of the Corporation without recovering from suppliers.

2.2.3 Unreconciled Control Accounts

According to the financial statements, out of the entire debtors, 87.4 per cent or Rs.4,176,881,984 was receivable from the Medical Supplies Division. However, according to the accounts records of the Medical Supplies Division, that balance had been Rs.4,013,750,000. Further, action had not been taken to identify reasons for the difference of

Rs.163,131,984 by preparing reconciliation statements of balances and to adjust them in accounts. Even though this matter was pointed out by audit reports of preceding years, action had not been taken to rectify them.

2.3 Accounts Receivable and Payable

The following observations are made.

(a) Out of the balance of Rs.4,176,881,984 receivable from the Medical Supplies Division, debtors balance of Rs.202,974,314 had been older than 6 to 17 years and the age analysis for debts amounting to Rs.3,973,907,670 had not been made available to audit.

(b) Even though debtors should settle debts within a period from 30 days to 45 days according to the Policy of the Corporation, out of the debtors balance of Rs.602,087,573 recoverable from the Private, Government and Semi-Government institutions, the outstanding debt balance older than 5 years amounted to Rs.13,331,781.

(c) An amount estimated by the Corporation as insurance claims receivable before the receipt of concurrence of the Insurance Corporation, had been brought to account in the balance of Rs.5,046,889 of the Insurance Claim Account, receivable as at 31 December 2015. As such, insurance claims of Rs.3,064,850 remaining over a period ranging from the year 2003 to the year 2013 could not be recovered.

(d) The balance of the Container Deposit Account as at 31 December 2015 had been Rs.10,223,824 and out of that, deposits amounting to Rs.5,136,000 had not been recovered over a period between 02 and 08 years.

(e) Advances amounting to Rs.5,669,617 issued to a service supplier in 40 instances during three preceding years for the installation of a computer system and advances amounting to Rs.4,749,631 issued to suppliers during the period from the year 2007 to the year 2012 had not been settled even by 31 December 2015.

(f) The balance of the Bank Bills Payable Account as at 31 December 2015 amounted to Rs.2,411,989,869. Out of that, a sum of Rs.6,379,974 not paid to suppliers older than 3 years, comprised of 100 per cent value of the Letters of Credit and the retention money.

2.4 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance with laws, rules, regulations and management decisions had been as follows.

	Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a)	Financial Regulations of the Democratic Socialist Republic of Sri Lanka Financial Regulation 371	Sub-Imprests totalling Rs.108,084 issued in 17 instances during the year under review had been settled after delays ranging between 14 and 150 days. Further, action had not been taken even by 15 June 2016 to settle advances totalling Rs.566,825 issued in 04 instances to the Officers of the Corporation during the year under review.
(b)	Public Enterprises Department Circular No. PED/57 of 11 February 2011	Donations and sponsorship allowances exceeding Rs.100,000 in value totalling Rs.10,043,000 had been paid in 39 instances during the year under review to private institutions contrary to the circular instructions.
(c)	Treasury Circular No. 842 of 19 December 1978	A Register of Fixed Assets had not been properly maintained in respect of assets such as lands, computers, equipment, furniture and fittings costing Rs.1,633,302,106 as at 31 December 2015.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Corporation for the year ended 31 December 2015 had been a net profit of Rs.619,598,174 as compared with the corresponding net profit of Rs.549,409,084 for the preceding year, thus indicating an improvement of Rs.70,189,090 in the net profit of the year under review as compared with the preceding year. The increase in the income from sales by Rs.2,329,523,502 and the income from other operations by Rs.25,521,619 and the decrease in the financial expenditure by Rs.147,449,309 and the expenditure on other operations by Rs.186,934,386 in the year under review as compared with the preceding year, had mainly impacted to the above improvement.

An analysis of financial results of the year under review and 04 preceding years revealed a continuous financial surplus from the year 2011 up to the year under review. Nevertheless, it had fluctuated annually after the year 2012. Taking into consideration the employees' remuneration, Government tax and depreciation on the non-current assets, the contribution of the Corporation which was Rs,1,614,236,294 in the year 2011 had improved up to Rs.2,500,345,125 in the year 2015 with fluctuations between 6 per cent and 29 per cent.

3.2 Legal Action instituted against or by the Corporation

External institutions and Officers had filed 05 cases in the Courts against the Corporation in connection with the breach of fundamental right relating to bid award process, demotion from post and blacklisting and out of that, the compensation claimed for one case amounted to U.S.$ 948,759. The Corporation had filed 03 cases in the Courts against 03 external institutions claiming compensation totalling Rs.7,862,551.

4. Operating Review

4.1. Performance

The following observations are made.

(a) Action had been taken for achievement the main objectives such as manufacture, purchase of locally manufactured drugs, import, export, sales, distribution, processing, storing and packing in terms of the Notification published in the Gazette Extraordinary No.14,976/8 dated 22 September 1971 of the Government of Sri Lanka. Nevertheless, action had not been taken to achieve the main objectives such as Pharmacological and Pharmaceuticals research and the standardizations of drugs, quality control of drugs, establishment of fine chemical manufacturing industries and sponsoring them, undertaking of market research in Sri Lanka and abroad on drugs and acquisition of trademarks and patents relating to drugs.

(b) The Corporation had failed to achieve the following activities included in the Action Plan prepared for the year under review.

(i) Minimize the level of outstanding stocks to 5 per cent.
(ii) Coupling of suppliers who supply to the Medical Supplies Division and State Pharmaceuticals Corporation on selected items.
(iii) Improvement of the Scheme of Recruitment and formulation and implementation of Transfer Policy.
(iv) Implementation of an incentive system based on the performance.
(v) Publish a handbook for employees' grievances.
(vi) Implementation of Enterprises Resources Planning System to link all operational centres.
(vii) Establishment of a Planning Division.

4.2 Operating Activities

The following observations are made.

(a) Out of drugs ordered by the Medical Supplies Division, the Corporation had failed to supply a considerable quantity of drugs within a specified period due to reasons such as failure to take action to discuss with the Medical Supplies Division in respect of problems such as non-receipt of orders with adequate time gaps and increase the number of orders from time to time and to make remedies thereon, failure to make an adequate effort to obtain drug samples within the due period and to carry out the preshipment sample test within the due period. Medicines take action to import drugs without the certificate of the National Regulatory Authority and failure to take action to minimize the time spent for various problems arising in the procurement process. According to the information presented to audit by the Corporation, it had failed to supply 360 items of drugs out of 672 ordered in the year 2013 and 103 items of drugs out of 610 ordered in the year 2014 and the details in respect of the number of orders and supplies received for the year under review had not been made available to audit.

(b) The shortage of stocks had been attributed mainly to matters such as delay in opening Letters of Credits due to delay in testing of preshipment samples and pack clarification make amendments to the Letters of Credits and delay in issuing orders or indents. However, adequate attention had not been paid to minimize such delays. Drugs had to be purchased locally during the year under review by overspending Rs.28,956,276 than the imported price in 10 instances of shortages of stocks.

(c) Even though the drugs sent for sample test when the bids are make, should be destroyed after the relevant test, 48 samples had been retained in the stores without being destroyed, despite the elapse of 01 to 03 years after obtaining the approval for destruction.

(d) According to the age analysis of Goods in Transition Account as at 31 December 2015, it had been confirmed that stocks costing Rs.175,929,700 and Rs.5,544,669 remained as stocks in transit for over 6 months and over one year respectively. Stocks not taken over by the Medical Supplies Division existed as stocks in transit for a long period. However, the Corporation had failed to find out reasons for not taking over of stocks and to take remedial action.

(e) Out of the drugs purchased for the sale of the Corporation, drugs costing Rs.141,420,110 had become unsaleable by 31 December 2015. However, according to the physical stock verification reports, the cost of that stock had only been Rs.99,436,700, thus indicating a difference of Rs.41,983,410. Out of that difference, explanations for the Rs.5,906,462 had been made available to audit but reasons for the further difference of Rs.36,076,948 had not been made available. As such, there is a possibility of unsuitable stocks being issued for sale to the market due to the physical non-existence of damaged stocks and it was observed that there is a probability of quality failed drugs reaching the consumers.

(f) Out of the 32 Osusala Outlets in operation during the year under review, 17 Osusala Outlets had sustained losses totalling Rs.26,618,559. However, 05 Osusala Outlets at Avissawella, Ampara, Hambanthota, Jaffna and Piliyandala had sustained losses continuously from the year 2012 even up to the year under review. The loss sustained by those 05 Osusala Outlets represented 47 per cent of the overall loss sustained in the year under review.

(g) The Management had not taken adequate action even by 31 December 2015 for the recovery of a sum of Rs.692,818,791 recoverable from suppliers for the quality failed, damaged and outstanding drugs for which payments had been rejected by the Medical Supplies Division.

4.3 Procurement Process

The following observations are made.

(a) A number of 275,000 bottles of ErithromycinEthyl succinate oral suspension costing a total of Rs.22,130,460 had been purchased in the year 2011 for the Medical Supplies Division from the sole supplier who submitted bids. However, the written evidence for confirmation of the transparency of bidding opening activities had not been made available. Moreover, the bid could have been rejected due to matters such as unavailability of samples with the bid, failure of the quality of a drug supplied in the year 2006 and the lack of effective competition. However, it had been decided to purchase that drug by making a false statement that no complaint whatsoever had been made against this supplier after the year 2005 instead. Though 123,393 bottles of the drug with two year shelf life had been purchased, those had failed in quality within a period close to one year.

(b) Even though a sum of Rs.2,837,103 had been spent for the Dealer’s convention in the year under review, the approved detailed budget had not been made available to audit. Further, a sum of Rs.1,097,672 had been spent for the reception hall and food without calling for bids. In addition to that, bids had been called for lighting, photography, music, dancing and printing of invitations by considering as one item included in the Event Management and the entire amount spent had been Rs.1,200,000. As such, it was observed that the above expense had increased by Rs.756,880 or 171 per cent in the year under review as compared with the preceding year.

4.4 Identified Losses

Drugs costing Rs.22,190,387 which were being transported without obtaining insurance cover in the years 2013 and 2014 had been destroyed due to a fire that broke out in the ship. The entire loss including the sum of Rs.5,687,874 spent for valuation of that loss, had been Rs.27,878,261.

4.5 Staff Administration

Vacancies in 32 executive posts, 82 non-executive posts and 20 posts in the minor staff existed by 31 December 2015. However, 44 persons and 06 persons had been recruited on permanent and contract basis respectively for 27 other executive posts, 22 non-executive posts and 01 post in the minor staff exceeding the approved cadre.

5. Accountability and Good Governance

5.1 Procurement Plan

Procurement Time Schedule had not been prepared for the Procurement Plan prepared for orders received from the Medical Supplies Division. A Procurement Plan and a Procurement Time Schedule had not been prepared in respect of purchase of medical supplies purchased for the sale of the Corporation and other assets purchased for the Corporation.

5.2 Budgetary Control

According to the revised budget prepared for the year under review, variances ranging from 35 per cent to 515 per cent were observed between the estimated and the actual expenditure in 26 items of expenditure out of 66 total items of expenditure thus indicating that the budget had not been made use of as an effective instrument of management control.

5.3 Performance of Environmental and Social Responsibilities

The following observations are made.

(a) Even though drugs and surgical equipment purchased for the sale and for the Medical Supplies Division should be subjected to the quality test before issuing, out of 274 items of drugs selected at the audit test check, 69 items of drugs had been tested after issuing them. It had been identified that out of the drugs issued during the year under review, drugs costing Rs.13,484,980 had failed the quality and those drugs had been issued to the patients. Under such circumstances, it was observed that there was a high risk of quality failed drugs reaching the patients for consumption.

(b) Stocks of drugs costing Rs.237,650 failed in quality and close to expiry of validity had been issued in 17 instances during the year under review for Government hospitals, medical clinics, schools and Army institutions as donations.

6. Systems and Controls

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 areas of control.

	Areas of Systems and Controls	Observations
(a)	Stock Control	Failure in taking steps to minimize shortages and surpluses of stocks and failure to identify and adjust the differences between the stock quantities mentioned in Bin Cards and stock quantities in the computer system.
(b)	Financial Control	Failure in collecting money for debit notes efficiently.
(c)	Marketing Management	Failure in taking adequate action to find out reasons for losses and minimize them.