

State Pharmaceuticals Manufacturing Corporation of Sri Lanka - 2015

The audit of financial statements of the State Pharmaceuticals Manufacturing Corporation of Sri Lanka for the year ended 31 December 2015 comprising the statement of financial position as at 31 December 2015 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes 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

The 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.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the State Pharmaceuticals Manufacturing 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

The assets costing Rs.94,841,186 had been fully depreciated as the useful life of non-current assets had not been reviewed annually in terms of Sri Lanka Accounting Standard 08. However, they had still been in use. Accordingly, action had not been taken to revise the estimated error.

2.3 Accounts Receivable and Payable

The following observations are made.

- (a) The Corporation had failed to recover even by 16 March 2016 the discounts amounting to Rs.90,933 recoverable from two dealers who failed to achieve the targets of monthly sales during the year under review.
- (b) The Value Added Tax amounting to Rs.633,049 relating to the year 2010 had not been remitted to the Department of Inland Revenue.

2.4 Transactions not Supported by Adequate Authority

The following observations are made.

- (a) The preliminary activities for entering into partnership collaborations had been commenced in 05 instances during the year under review without obtaining the approval of the Cabinet of Ministers for the policy decision of entering into partnership collaborations with local and foreign companies and the professional charges amounting to Rs.115,000 had been paid thereon.
- (b) The non-current assets costing Rs.8,048,368 had been disposed of during the year under review without obtaining the approval of the Board of Directors.

2.5 Non-compliances with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance with laws, rules, regulations and management decisions were observed.

**Reference to Laws, Rules, Regulations and
Management Decisions**

Non-compliances

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- (a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka
- (i) Financial Regulation 371 (2)(c)
- Three Sub-Imprests totalling Rs.247,403 issued in the year under review had been settled after delays between 01 month and 11 months.
- (ii) Financial Regulation 571 (2)
- Action had not been taken to settle or credit the bid bonds totalling Rs.2,238,121 lapsed for more than 2 years since the date of deposit that to the Public Revenue, existed as at the end of the year under review.
- (b) Nineteenth Supplement to Guideline 9.3.1(b) of the Procurement Guidelines published on 06 September 2010.
- When the expenditure on repairs to motor vehicles exceed Rs.200,000, the approval of the Secretary to the Line Ministry should be obtained thereon. Nevertheless, contrary to that, a sum of Rs.279,087 had been spent for repairing of a motor vehicle in the year under review.
- (c) Recruitment Scheme for the Minor Staff
- Even though the persons should be selected and recruited by publishing vacancies in newspapers, holding interviews and giving marks for their qualifications, contrary to that, 13 minor employees had been recruited on contract basis in the year under review.
- (d) Recruitment Scheme for the Non-executive Employees
- Even though the persons should be selected and recruited by publishing vacancies in newspapers, conducting a written examination and holding an interview and giving marks for their qualifications, contrary to that, recruitments had been made for the post of Cashier on contract basis in the year under review.
- (e) The letter No. DMS/E4/10/4/090/2 dated 09 March 2009 of the Department of Management Services addressed to the Secretary of Health, Nutrition and Indigenous Medicine
- (i) Paragraph No. 02-01
- Contrary to Circular provisions, transport

allowances amounting to Rs.4,700 and Rs.3,000 had been paid monthly to the Executive and Non-executive officers of the Corporation respectively since the year 2009 without considering the distance travelled.

(ii) Paragraph No. 02-02

Even though only a sum of Rs.4,000 could be paid as a monthly production incentive to the members of the staff in terms of the Circular, contrary to that, production incentives had been paid to the entire staff subjected to a monthly maximum limit of Rs.12,000 with effect from 01 July 2011. As such, an overpayment of Rs.12,292,265 had been made during the year under review.

(e) Public Finance Circular No.438 of 13 November 2009

(i) Even though the disposable goods accumulated in Government institutions should be disposed promptly, the unserviceable non-current assets costing Rs.50,103,387 fully depreciated as at 31 December 2015 had not been disposed of.

(ii) Even though the unusable stocks of raw materials costing Rs.15,262,967 and packing materials costing Rs.1,820,250 had been accumulated in the stores by 31 December 2015, action had not been taken to dispose of them properly.

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 surplus of Rs.262,323,747 as compared with the corresponding surplus of Rs.183,848,683 for the preceding year, thus indicating an improvement in the surplus by Rs.78,475,064 or 43 per cent in the year under review as compared with the preceding year. Even though the cost of sales and expenditure on tax had increased by Rs.216,092,507 and Rs.69,544,789 respectively, the increase in the income from sales by Rs.342,257,122 had mainly attributed to the improvement in the above financial result.

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. Taking into consideration the employees' remuneration,

Government tax and depreciation for the non-current assets, the contribution of the Corporation which was Rs,551,241,277 in the year 2011 had improved up to Rs.814,843,103 in the year 2015 with fluctuations between 6 per cent and 49 per cent.

3.2 Analytical Financial Review

As the current ratios had been 9:1 and 11:1 and the liquidity ratios had been 5:1 and 8:1 in the year under review and the preceding year respectively, it was observed that the surplus working capital had not been made use of in an effective manner.

4. Operating Review

4.1 Performance

The following observations are made.

- (a) The main objectives of the Corporation in terms of the Notification published in the Gazette Extraordinary No.456/21 dated 04 June 1987 of the Democratic Socialist Republic of Sri Lanka were manufacturing, processing, stocking, packing and re-packing of drugs, provision of technical assistance for the manufacture and processing of drugs, Pharmacological and Pharmaceutical Research and the Standardization of Drugs and the marketing of drugs produced. Out of them, the Corporation had failed to achieve the objectives such as Pharmacological and Pharmaceutical Research and the Standardization of Drugs adequately.
- (b) As the progress reports had not been prepared in accordance with the format in which the Annual Action Plan for the year 2015 was prepared, a proper review could not be made in respect of the progress.

4.2 Operating Activities

The following observations are made.

- (a) The total value of two raw materials amounting to Rs.115,498, which could not be issued for the manufacture of pharmaceuticals due to failure in identifying the type and specifications due to missing of labels, had been written off against the profit during the year under review. However, measures had not been taken to identify the officers who are responsible for the missing of labels and to take action against those officers in terms of Financial Regulations.
- (b) Out of 88 types of raw materials checked, stocks of 8 types of raw materials had been purchased exceeding their stock requirements from 84 per cent to 270 per cent due to non-maintenance of optimum levels of stocks for raw materials and stocks of two types of packing materials had remained zero. Further, it was observed in audit that this position may cause a trend in increasing the amount of expired stocks and causing deficits in working capital as well as to the delay in production and urgent purchases.

- (c) Out of the drugs ordered by the Medical Supplies Division for the year under review, 710.06 million units of 20 types of drugs valued at Rs.447,494,529 could not be supplied during the year under review due to reasons such as, shortages in stocks of raw materials, packing materials and coverings of tablets, inadequacy of the capacity of the machines and technical faults of the production process.
- (d) It was established by the progress reports that a target of sale of 354.19 million units of 10 types of drugs out of the targeted sale of 2,152 million units of 84 types of drugs could not be achieved according to the Marketing Plan prepared for the year under review.
- (e) The quantity of sale of 16 types of drugs sold to the distributors had decreased in ranges from 7 per cent to 75 per cent in the year under review as compared with the preceding year. As such, that sales income had decreased by Rs.39,186,940 or 6.6 per cent.
- (f) Even though the pricing of drugs with a profit margin of 12 per cent on the cost in the sale of drugs to the Medical Supplies Division was the policy, the price of 13 types of drugs had been determined and sold at a less profit margin than that. As such, it was revealed that the sales income of 43 types of drugs which were subjected to audit test check only within the last 06 months of the year under review, had been deprived of by Rs.1,929,118.

4.3 Management Activities

The following observations are made.

- (a) Even though stock surpluses valued at Rs.851,978 and stock shortages valued at Rs.148,573 revealed at the physical verification carried out as at 31 December 2015 had been adjusted in accounts, action had not been taken to identify the reasons therefor and take remedial action thereon.
- (b) Even though the period of collection of debts from debtors was 16 days according to the financial statements presented, a debt period of 50 days had been given. Even though opportunities had been given to settle the debts amounting to Rs.1,176,684 in 2 instances exceeding the above debt period, a methodology had not been established for the recovery of interest for delay.

4.4 Identified Losses

The following observations are made.

- (a) Out of 250 Kilogrammes of raw materials named “Saccharin Sodium” purchased at a cost of Rs.512,295 in the year 2012, 100 Kilogrammes had not been used before expiry, thus incurring a loss amounting to Rs.239,156.
- (b) The total cost amounting to Rs.3,798,626 of raw materials and packing materials which were identified as unusable due to reasons such as discarding raw materials purchased due to ceasing of manufacture of certain drugs in the year under review

and failure in quality of the raw materials nearing expiry of validity, had been written off against the profit.

- (c) The total loss of the drug wholesale outlet commenced at Dharmapala Mawatha, Colombo 07 on 06 January 2015 amounted to Rs.985,113 and it had been closed down since April 2015.

4.5 Delayed Projects

Even though the approval of the Board of Directors had been obtained to construct 03 buildings at the total cost estimate of Rs.400,000,000 and to spend Rs.100,000,000 out of that in the year under review, the approval of the Cabinet of Ministers had not been obtained thereon. According to the Action Plan prepared for the year under review, construction works should have been commenced by May 2015. Nevertheless, only the appointment of Consultants for two buildings only had been made even by 31 December 2015.

4.6 Staff Administration

Even though vacancies existed in 08 posts of Executives, 12 posts of Non-executives and 02 posts of minor employees as at 31 December 2015, three persons and 37 persons had been recruited on permanent and contract basis respectively to one other Executive post, 07 Non-executive posts and 32 minor employee posts exceeding the approved cadre.

5. Accountability and Good Governance

5.1 Internal Audit

An internal audit had not been carried out relating to purchases of fixed assets and raw materials which covered 78 per cent of the total expenditure included in the Internal Audit Plan.

5.2 Procurement Plan

The targeted dates for the completion of each procurement had not been included in the main Procurement Plan prepared for the year under review and the procurement time schedule as well had not been prepared.

5.3 Budgetary Control

As purchases ranging from 27 per cent to 1400 per cent exceeding the estimated amount of 18 types of raw materials had been made, the realistic estimates had not been prepared. Moreover, variations ranging from 50 per cent to 167 per cent were observed between the estimated and actual expenditure of 17 items of expenditure out of 62 items of overall expenditure, thus indicating that the budget had not been made use of as an effective instrument of management control.

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) Fixed Assets Control	Failure in obtaining proper approval for disposal of assets and the failure to dispose of them efficiently.
(b) Stock Control	Non-maintenance of optimum levels of stocks and failure to note the issue of stocks.