State Pharmaceuticals Corporation of Sri Lanka – 2016

The audit of financial statements of the State Pharmaceuticals Corporation of Sri Lanka for the year ended 31 December 2016 comprising the statement of financial position as at 31 December 2016, 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 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 judgment, including the assessment of risks of material misstatements 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 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-section (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 Qualified 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 2016 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 Sri Lanka Accounting Standard 19 has encouraged the creation of an investment plan for the liability for the retirement gratuity in order to minimize the risks of future obligations action in accordance therewith had not been taken.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) The debit notes issued during the year under review for the recovery of the cost of the drugs purchased for the Medical Supplies Division and for sale by the Corporation which had been confirmed as quality failed and the various charges thereon from the suppliers concerned had been brought to account on the cash basis and as such a sum of Rs.198,382,873 recoverable as at 31 December 2016 from the suppliers had been omitted in the accounts.

(b) Even though the expenditure on sample checks carried out prior to shipping of the drugs should be recovered from the suppliers in accordance with the agreements, a sum of Rs.826,599 spent in that connection from January to June of the year under review had been brought to account as expenditure of the Corporation, without being recovered from the suppliers.

2.2.3 Unreconciled Control Accounts

According to the financial statements, 91.2 per cent of the total debtors or Rs.5,771,132,176 remained receivable from the Medical Supplies Division whereas according to the accounting records of the Medical Supplies Division, that balance amounted to Rs.5,611,457,947. The Corporation had failed to identify the reasons for the difference of Rs.159,674,229 by preparing the Statements of Reconciliation of Balances and rectify the difference.

2.2.4 Unexplained Differences

According to the information obtained from the Computer Division of the Corporation and according to the Physical Stock Verification Reports a difference of Rs.153,719 existed in the value of validity expired drugs.

2.2.5 Lack of Evidence for Audit

The confirmation of balances relating to the balances amounting to Rs.1,860,427 relating to 11 creditors out of the trade creditors balance of Rs.523,256,337 as at 31 December 2016 had not been furnished to Audit in order to confirm the balances.

2.3 Accounts Receivable and Payable

The following observations are made.

(a) A sum of Rs.211,810,803 out of the balance amounting to Rs.5,771,132,176 receivable from the Medical Supplies Division had been debts old between 7 years to 18 years. The age analysis of debts amounting to Rs.5,559,321,373 had not been furnished to Audit.

(b) According to the policy of the Corporation, the debts of the trade debtors should be recovered within 30 days to 45 days from the date of sale. Nevertheless, out of the debtors balance of Rs.552,045,880 as at 31 December 2016, the Corporation had failed to recover a sum of Rs.13,343,931 from the private, the Government and semi-Government institutions over periods exceeding 5 years and for the recovery of a sum of Rs.9,044,299 from the Parliament of Sri Lanka over a period exceeding one year. The Chairman of the Corporation had commented that legal steps had been taken for the recovery of the debtors balances out of that amounting to Rs.10,440,049.

(c) The insurance indemnity receivable as at 31 December 2016 amounted to Rs.3,947,890 and the Corporation had failed to recover a sum of Rs.1,855,372 over periods ranging from 2 years to 13 years. Even though the irrecoverability of a sum of Rs.842,504 had been identified, action had not been taken to examine the reasons for that and recover from the parties responsible.

(d) The balance of the Container Deposits Account as at 31 December 2016 amounted to Rs.10,333,759 and the Corporation had failed over periods ranging from 2 years to 8 years for the recovery of a sum of Rs.5,810,983 out of that balance.

(e) The advances amounting to Rs.105,672 and Rs.150,000 paid in the years 2013 and 2014 for carrying out repairs to an electricity generator and the installation of a computer system respectively and the advances amounting to Rs.3,601,322 issued to the suppliers from the year 2007 to the year 2012 had not been settled even by 28 February 2017, the date of audit.

(f) The balance of the Bills Account payable to the Bank as at 31 December 2016 amounted to Rs.1,849,474,481. Out of that a sum of Rs.30,779,344 represented the value of 100 per cent of value of letters of credit and retention money not paid to suppliers and older than 3 years.

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

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

Reference to Laws, Rules and Regulations	Non-compliances
(a) Circular No. PED/57 of 11 February 2011 of the Department of Public Enterprises	Contrary to the provisions in the circular, grants and sponsorships each exceeding Rs.100,000 totalling Rs.7,334,250 had been paid in 25 instances in the year under review to private institutions.
(b) Public Finance Circular No. 3/2015 of 14 July 2015	The ad hoc sub imprests totalling Rs.264,285 issued in 17 instances in the year under review had been settled after delays ranging from 13 days to 195 days.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Corporation for the year under review amounted to a net profit of Rs.1,241,744,631 as compared with the corresponding net profit for the preceding year amounting to Rs.619,598,174 , thus indicating an improvement of Rs.622,146,457 in the net profit of the year under review as compared with the preceding year. Even though the direct expenditure for the year under review as compared with the preceding year had increased by a sum of Rs.6,487,187,300, the increase of sales income by a sum of Rs.7,791,707,690 had been the main reason for the above improvement.

An analysis of the financial results for the year under review and 4 preceding years indicated continuous net profits from the year 2012 to the year under review, but it had fluctuated annually. Nevertheless, in the re-adjustment of the employees’ remuneration, the Government taxes and the depreciation on non-current assets to the financial results indicated that the contribution of Rs.1,692,199,699 in the year 2012 had improved with fluctuations ranging from 6 per cent to 31 per cent to Rs.3,283,259,319 in the year 2016.

3.2 Analytical Financial Review

The Gross Profit Ratio for the year under review, as compared with the preceding year had decreased by 0.6 per cent whilst the Creditors Turnover Ratio had increased by 15 times and the period of payment of debts had decreased by 3 days. It was observed that attention should be paid in this connection and make the operating activities of the Corporation efficient.

3.3 Legal Actions instituted against the Corporation or by the Corporation

Four cases had been filed in the Courts by external institutions and officers on the breach of fundamental rights, demotion from the posts and blacklisting in relation to the Bid Award Process. The compensation relating to one of those cases amounted to US $ 948,759. The Corporation had filed 3 cases in the Courts against 03 external parties claiming compensation amounting to Rs.7,862,551.

3.4 Unusual increase in Expenditure

The Bank Overdraft interest expenses of the preceding year and the year under review amounted to Rs.734,134 and Rs.5,434,349 respectively and that expenditure of the year under review, as compared with the preceding year, had increased by 640 per cent. Even though the supplies made to the Medical Supplies Division had increased, the delays in the receipt of money in that connection had been the reason for obtaining higher Bank Overdraft Facilities.

4. Operating Review

4.1 Performance

The following observations are made.

(a) Even though action had been taken for the achievement of the major objectives such as the manufacture of drugs, the purchase of locally manufactured drugs, import, export, marketing, distribution, processing, storage and packaging in accordance with the Notification published in the Gazette Extraordinary No. 14976/8 of the Government of Sri Lanka dated 22 September 1971, action had not been taken for the achievement of the major objectives such as the establishment of the industries manufacturing fine chemicals and providing assistance thereto, and the commencement of research work in Sri Lanka and foreign countries with regard to marketing of drugs.

(b) In view of the commencement of work on the establishment of a cold room in the premises of the Main Stores at Ratmalana, the construction of a building for the Jeewani Manufacturing Division and the construction of the Osusala at Colombo 7 which had not been included in the Action Plan for the year under review, the Corporation had not been able to achieve the following activities included in the Action Plan. As such, it was observed that the Corporation had not taken action in accordance with the Action Plan.

(i) Formulation of a methodology for the direct importation of drugs without the intervention of the intermediaries.
(ii) Introduction of three new distributors annually.
(iii) Implementation of the final installation and systems training stages of the Enterprises Resources Planning System implemented for the co-ordination of all Operating Divisions of the Corporation.
(iv) Development of the Manufacturing Plan and introduction of new products.
(v) Amendment of the Scheme of Recruitment.

4.2 Management Activities

The following observations are made.

(a) Even though the Corporation had obtained a building at Badulla Bus Stand Trading Complex on lease basis through a lease agreement entered into on 19 September 2000 by the Corporation with the Badulla Municipal Council and the Urban Development Authority and opened a State Osusala and the building that fell vacant due to the removal of the Osusala from that building, on 17 November 2011 had been leased out to an individual for a period of 5 years from 15 January 2013 at a monthly lease rental of Rs.55,000. According to the agreement entered into in that connection, the lessor had the right to cancel the lease agreement if the lessee fails to pay the lease rental for a period of 3 months. Even though the lessee had defaulted the payment of lease rental for a period of 9 months after 05 September 2013, the Corporation had not taken action for the cancellation of the lease agreement. Even though the lessee had paid Rs.1,890,000 by cheques and in cash from time to time on being informed by the Corporation the non-payment of lease rental, cheques valued at Rs.1,330,000 out of that had been dishonoured. The total arrears of the lease rental which the Corporation had failed to recover as at 14 March 2017 amounted to Rs.1,805,000.

(b) The matters observed in the examination of the purchase of 500,000 Units of the Omeprazole Capsules 20mg during the year under review are given below.

(i) The Departmental Procurement Committee had decided to award 20 per cent of the order to one of the two suppliers who had quoted the lowest price according to the quotations received an award the balance 80 per cent to the supplier who had quoted the third low price, who had made supplies previously. After the allegation made by the company which offered equal lowest price which did not get the award that the Corporation had awarded the bid contrary to the Procurement Guidelines, the Procurement Committee had decided again to award 10 per cent each to the two supplies who quoted the lowest price. Any acceptable reasons for the decision taken to award 20 per cent of the order to the two lowest bidders and to award 80 per cent to the supplier who had quoted the third lower quotations had not been given in the report of the Procurement Committee.

(ii) Out of 50,000 units purchased from one of the suppliers who quoted the lowest price, 47,684 could not be sold due quality failure and 41,915 units of that remained in the stores whilst 5,769 units had been issued to patients. The loss amounting to Rs.3,260,568 had not been recovered from the supplier even by 18 April 2017, the date of audit.

(iii) The supplier who was awarded 80 per cent of the total bid had supplied 125,000 units on 19 November 2015 and 75,000 units and 150,000 units on 24 November 2015 and 08 February 2017 respectively, all totalling 350,000 units of drugs. The stocks supplied had been taken over without carrying out a proper examination, a test carried out on a complaint made by a consumer revealed that 62,697 units of the stock of 75,000 units supplied had failed the quality and by the that time 12,303 units had been issued to patients. The value of the rejected stock amounted to Rs.5,063,410 and that had not been recovered from the supplier even by 01 August 2017.

4.3 Operating Activities

The following observations are made.

(a) According to the age analysis of the Stocks in Transit Account as at 31 December 2016, it was confirmed that the stocks costing Rs.5,472,779 had been stocks in transit for more than 6 months whilst the stocks costing Rs.9,917,600 had been stocks in transit for more than one year. In view of the delay in the issue of Debit Notes for the stocks taken over by the Medical Supplies Division and the failure to find out the reasons for the stocks not taken over by the Medical Supplies Division and taken remedial action had resulted in such stocks remaining as stocks in transit over long periods.

(b) Out of the drugs purchased for sale by the Corporation the total cost of quality failed and the validity expired drugs in the preceding year amounted to Rs.25,579,947 and Rs.21,257,018 respectively whilst the cost of quality failed and validity expired drugs of the year under review amounted to Rs.110,007,776 and Rs.19,980,259 respectively. The value of the drugs which had become unsuitable for sale, as compared with the preceding year, had increased by 177 per cent. Out of the drugs which had failed the quality in the years 2015 and 2016 amounting to Rs.135,587,723 , a sum of Rs.35,800,897 had not been recovered even by 31 August 2017 and the total loss incurred by the Corporation due to the expiry of validity amounted to Rs.41,237,277.

(c) Out of the drugs purchased for sale by the Corporation, drugs valued at Rs.287,216,327 had become unfit for sale by 31 December 2016. Nevertheless, according to the report on the physical verification the cost of that stock amounted to Rs.258,125,317 thus indicating a difference of Rs.29,091,010. Even though the explanation relating to Rs.4,527,422 out of that difference had been furnished to Audit, the reasons for the balance difference Rs.24,563,588 had not been furnished. In view of the unavailability of the damaged stocks physically the possibility of stocks not fit for sale being issued to the market cannot be ruled out in audit.

(d) Out of 32 Osusala Outlets in operation during the year under review, 9 Osusala Outlets had incurred losses and the total of the losses amounted to Rs.12,196,684. Six Osusala Outlets at Avissawella, Minuwangoda, Diyatalawa, Tangalla, Hambantota and Jaffna had incurred losses continually from the year 2013 to the year under review whilst 88.2 per cent of the total loss for the year under review had been incurred by those 6 Osusala Outlets.

(e) The total cost of the drugs for which the Medical Supplies Division had rejected the payments by 31 December 2016 due to quality failure, damage and shortages of drugs amounted to Rs.802,279,379. The Corporation had failed to recover a sum of Rs.759,329,236 out of that from the suppliers even by 01 August 2017. Out of that, a sum of Rs.186,488,579 remained recoverable from the blacklisted suppliers and as such the recovery of that amount is uncertain.

4.4 Procurement and Contract Process

The following observations are made.

(a) According to paragraph 6.3.6 of the Government Procurement Manual, if the bidders revises their quotations, the amended prices can be sent before the opening of the bids. That should be noted in the Note on the Bid opening and the qualified bidder should be selected by opening the bids at the time shown in the Bid Notice. Nevertheless, in the opening of the bids for the purchase of 55,000 units of the drug Valgaciclorir in the year under review, the bid had not been awarded to the bidder who had submitted the minimum price of Rs.75,317,861 recommended by the Technical Evaluation Committee, the bid had been awarded 65 days after the bid opening, to a bidder who had amended the prices from Rs.80,921,214 to Rs.69,325,634.

(b) Even though the Medical Suppliers Division had made an order for 30,000 litres of Ultra Sound Transmission Gel for the year 2016, a stock of 50,000 litres had been purchased and dispatched to the Medical Supplies Division on 16 December 2016. As the stock Handover Note for the 50,000 litre stock had incorrectly marked the quantity of litres, the stock had been retained without being taken over a period exceeding 04 months and as such it had not been possible to issue that to the Hospitals. The item which should be supplied to the Medical Supplies Division with a valid life period of 36 months had only a valid life period of 28 months by 17 April 2017.

(c) According to the information obtained from the Computer Division of the Corporation the value of the validity expired drugs during the year under review out of the drugs purchased for sale by the Corporation amounted to Rs.20,133,978. Out of that, the validity of drugs valued at Rs.19,981,558 had expired due to the purchase of drugs with less than two years of validity period as required by clause 2.2 of the agreement included in the bid documents.

(d) The matters observed during the course of examination of the administration activities of the contract for the installation of the electric lift of the Osusala Colombo 07 are given below.

(i) The Bid Documents had not been checked and approved in terms of the Guideline 5.3.1 of the Government Procurement Guidelines by the Technical Evaluation Committee and the Procurement Committee respectively.

(ii) Even though a maximum period of 21 days of bidding time should be allowed in terms of the Guideline 6.2.2 of the Government Procurement Guidelines, to the bidders in an invitation of bids under the National Competitive Bidding for them to submit the bids, only 14 days had been allowed in this matter for the submission of bids.

(iii) Even though the Guideline 6.3.6 of the Government Procurement Guidelines Stipulates that the procedures of the bid opening should be recorded in the prescribed format and should be signed by all members of the Bid Opening Committee, the Corporation had not so maintained the records of bid opening.

(iv) Even though the terms and conditions of the contract agreement required that the work of the contract should be completed by 22 August 2015, the Corporation had failed to get the work completed by 14 July 2017, the date of audit.

4.5 Staff Administration

The following observations are made.

(a) The number of vacancies in the cadre of the Corporation as at 31 December 2016 had been 160 and officers for 6 posts had been recruited exceeding the approved staff. In addition, 15 officers had been appointed on the acting basis and the covering of duties basis for 01 post of Executive Level and 14 posts of Non-Executive Level.

(b) Two Officers had been recruited on the contract basis for post of Manager (Procurement) included in the approved staff over a period of 2 years and the Manager (Enterprise Resources Planning) not existing in the approved staff over a period of 4 years.

5. Accountability and Good Governance

5.1 Internal Audit

An internal audit of the recruitment, promotion and transfers included in the Internal Audit Plan had not been carried out.

5.2 Procurement Plan

A Procurement Plan and the Procurement Time Schedules in connection with the medical supplies purchased for sale by the Corporation and the other assets purchased had not been prepared.

5.3 Budgetary Control

According to the revised budget prepared for the year under review, variances ranging from 35 per cent to 746 per cent existed between the estimated and the actual expenditure of 26 items of expenditure out of 70 overall items of 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 weaknesses in the following areas of control.

Areas of Systems and Controls	Observations
(a) Recovery of debts	Failure to ensure efficiency in the collection of money on Debit Notes.
(b) Control of Osusala Outlets	Failure to take adequate action to examine the reasons for losses with the objective of minimizing the losses.