State Pharmaceuticals Corporation of Sri Lanka - 2017

The audit of financial statements of the State Pharmaceuticals Corporation of Sri Lanka for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017, 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. A detailed report in terms of Section 13 (7)(a) of the Finance Act was issued to the Chairman of the Corporation on 21 June 2018.

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 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 risks of material misstatements of the financial statements, whether due to fraud or error. In making those risks 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 the 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 Basic 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 effect 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 as at 31 December 2017 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 Unexplained Differences

According to the financial statements, 90.55 per cent or Rs.9,267,922,705 of the total debtors should have been received from the Medical Supplies Division as at 31 December of the year under review. Nevertheless, according to the Appropriation Account of the Ministry of Health, Nutrition and Indigenous Medicine that balance represented Rs.9,049,836,862. Action had not been taken to prepare the reconciliation statements and to make necessary adjustments in the accounts having being identified the reasons for the difference of Rs.218,085,843.

2.2.2 Lack of Evidence for audit

Out of the trade creditors balances totalling Rs.818,160,881 relating to 210 creditors as at 31 December 2017, confirmation of balances relating to 106 creditors totalling Rs.48,844,761 were not made available for audit.

2.3 Accounts receivable and payable

The following observations are made.

(a) Of the balance of Rs.9,267,922,705 receivable from the Medical Supplies Division, a sum of Rs.211,810,803 had been old debtor balances remained for periods ranging from 8 to 19 years. An age analysis for the debtor balances totalling Rs.9,056,111,902 was not made available for audit.

(b) According to the credit policy of the Corporation, debts from trade debtors should be recovered within the period between 30 days and 45 days from the date of sale. However, the Corporation had failed to recover debts receivable from the Private, Government and Semi-government entities totalling Rs.12,327,940 remained recoverable for a period of more than 5 years and debts totalling Rs.9,044,299 receivable from the Parliament of Sri Lanka remained for more than one year, out of the debts balance of Rs.967,042,539 as at 31 December 2017.

The Chairman of the Corporation had informed the audit that legal action had been taken to recover debt balances of Rs.10,440,049.

(c) Insurance indemnities receivable as at 31 December 2017 amounted to Rs.2,507,547 and the Corporation had failed to recover a sum of Rs.1,835,198 therefrom since the period 2 to 12 years.

(d) The balance of the receivable container deposit account as at 31 December 2017 amounted to Rs.11,769,850 and the Corporation had failed to recover a sum of Rs.6,462,823 therefrom since the period 2 to 10 years.

(e) An advance of Rs.105,672 issued in the year 2013 for the repair of a generator and advances totalling Rs.2,971,688 issued to the suppliers during the period 2007 to 2012 had not been settled even by 22 March 2018, the date of audit.

(f) The balance of the bills payable account to banks as at 31 December 2017 amounted to Rs.2,773,021,077 of which a sum of Rs.4,859,879, consisting of 100 per cent value of letters of credit unpaid to the supplies and retention money which had remained older than 3 years.

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

Instances of non-compliance with laws, rules, regulations and management decisions are as follows.

Reference to Laws, Rules, Regulations etc.	Non-compliance
(a) Financial Regulations of the Democratic Socialist Republic of Sri Lanka	
Financial Regulation 770	(i) Even though, action should have been taken to use 49 items of fixed assets belonged to the 3 circuit bungalows closed down since the date of 24 June 2016 or to sell or dispose of them, unless they could be used with the recommendations of a Board of Survey in terms of the Financial Regulation, action had not been taken accordingly and kept in the ground floor of the Corporation even by 03 May 2018.

	(ii)	According to the Board of Survey reports conducted as at 31 December 2016, 117 items costing Rs.1,322,750 and 171 items, the cost of which was not stated had damaged. Action had not been taken to sell or dispose of the items which could not be used after being identified by appointing a Board of Survey in terms of the financial regulation.
(b) Public Administration Circular No.09/2007 (1) dated 24 August 2007.		Even though, the retired officers had been employed for the posts of Deputy General Manager (Human Resources and Administration), Deputy Manager (Maintenance and Constructions) and the supervisor, the Personal recommendation of the Secretary to the relevant Ministry had not been obtained.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial results of the Corporation for the year under review had been a net profit of Rs.1,089,431,741 as compared with the net profit of Rs.1,241,744,631 for the preceding year, thus indicating a deterioration of Rs.152,312,890 in the financial results of the year under review as compared with the preceding year. Increase of financial expenses by Rs.29,989,320 or 461 per cent in the year under review as compared to the preceding year had mainly attributed to this deterioration.

In analyzing the financial results for the year under review and the preceding 4 years, net profits were generated continuously since the year 2013 to the year under review but it had fluctuated annually and the net profit of Rs.777,218,094 in the year 2013 had increased to Rs.1,560,027,058 by the end of the year under review. However, re-adjusting the employees remuneration, government taxes and depreciation on non-current assets to the financial results, the contribution of the Corporation amounting to Rs.2,065,476,098 in the year 2013 had improved to Rs.3,261,654,325 in the year 2017 with fluctuations. The contribution of the year under review had decreased by 0.7 per cent as compared with that of previous year.

3.2 Analytical Financial Review

A deterioration of liquidity ratios in the year under review was observed as compared with the preceding year. The debtors turnover ratio had decreased by 1.7 times whereas the debt recovery period had increased by 31 days. By paying attention to that aspect, it was observed that the debt recovery of the Corporation has to be operated efficiently.

3.3 Legal cases initiated against or by the Corporation

Four cases against the Corporation had been filed by external parties and officers on the grounds of black listing, downgrading of posts and termination of posts and the Corporation had filed 5 cases against 5 external institutions, asking for compensation totalling Rs.23,372,660 in the court of law.

3.4 Abnormal increase in the expenditure

Bank overdraft interest expenditure in the previous year and the year under review amounted to Rs.5,434,349 and Rs.35,199,403 respectively, thus increasing by 548 per cent in the year under review as compared to the previous year. Even though, supplies to the Medical Supplies Division had increased, getting bank overdraft facilities increased due to delay in receiving money had been the reason therefor.

4. Operating Review

4.1 Performance

4.1.1 Planning

The Corporate Plan and the action plan had not been prepared, enabling to achieve the main functions of the Corporation such as the establishment of industries which produce tenuous chemicals and oblige them and to commence researches locally and foreign countries in respect of marketing of pharmaceuticals, published in the Government Gazette extra ordinary No.14976/8 of 22 September 1971, by which the Corporation was established.

4.1.2 Operations and Review

The Corporation had failed to achieve the following activities stated in the action plan prepared for the year under review.

(i) Preparation of a system for the direct import of pharmaceuticals without brokers.

(ii) Implementation of the stages Viz, final installation, system training, parallel running and operational acceptance of the system in the business resources planning system to be implemented in respect of Linking of all operations Divisions of the Corporation.

(iii) Linking of the business resources planning system with external systems.

(iv) Upgrading business continuity plan.

(v) Training of staff relating to the development of production plan for the inclusion of new products, procurement planning and commencement of production.

(vi) Improvement of construction facilities in order to Strengthening Laboratory facilities.

(vii) Improvement of the laboratory with modern and essential equipment.

(viii) Revision of the scheme of recruitment.

(ix) Strengthening the maintenance division under the improvement of common amenities.

Of these activities, activity Nos (ii) and (viii) had been included in the action plans since the year 2015.

4.2 Management Activities

A Rajya Osusala had been commenced in a leased building at the Badulla Bus stand trading complex by a lease agreement entered into with the Municipal Council, Badulla and the Urban Development Authority on 19 September 2000 by the Corporation. This Osusala had been removed from this building on 17 November 2011 and it had been leased out to another party for a period of 5 years since 15 January 2013 at a monthly rental of Rs.55,000. According to the agreement entered into therefor, if the lessee had not paid rental for a period of 3 months, the lessor had the right to terminate the lease agreement. However, the lessee had evaded the payment of rent during the period of 9 months after 05 September 2013 but the Corporation had not taken action to teminate the agreement. As a response to the notification made by the Corporation to the lessee in respect of non-payment, he had paid a sum of Rs.1,890,000 from time to time in cheques and cash but the cheques valued at Rs.1,330,000 had been dishonoured and the outstanding amount as at 21 March 2018, the date of audit, amounted to Rs.2,003,320.

4.3 Operating Activities

The following observations are made.

(a) It was established that the stock costing Rs.44,621,916 and the stock costing Rs.7,574,513 had been shown as goods in transit for the period over 6 months and over 01 year respectively in accordance with the age analysis of goods in transit account as at 31 December 2017. As a result of delays in the issue of debit notes for stocks taken over by the Medical Supplies Division and non-remedying the reasons for non-taking over goods by the Medical Supplies Division, those stocks had remained as goods in transit for a long time.

(b) Of the drugs purchased for sale by the Corporation, the total cost of quality failed and expired drugs in the previous year amounted to Rs.110,007,776 and Rs.19,980,259 and the year under review amounted to Rs.23,561,218 and Rs.80,834,686 respectively. Out of the quality failed drugs relating to the previous year and the year under review, costing Rs.133,568,994, drugs valued at Rs.26,603,418 had not been recovered from the relevant suppliers of drugs even by 26 March 2018. The total loss incurred by the Corporation due to expiration of drugs amounted to Rs.89,973,349.

(c) Out of 37 operating Osusals, 19 had incurred losses during the year under review and the total loss amounted to Rs.41,286,421. Seven Osusals located in the cities of Avissawella, Minuwangoda, Diyathalawa, Tangalle, Hambanthota, Jaffna and Ratmalana had incurred contineous losses from the year 2013 to the year under review. Any system had not been implemented in order to minimise losses and 37.54 per cent of the total loss of the year under review had incurred from those 07 Osusals.

(d) Even though, the value of debit notes issued to the suppliers for the recovery of cost incurred in respect of supply of quality failed and damaged drugs and short supplies to the Medical Supplies Division, administrative charges and distruction expenditure of those stocks amounted to Rs.1,303,740,147, a sum of Rs.579,996,167 therefrom had not been recovered. A sum of Rs.104,803,706 included therein should have been recovered from the black listed suppliers and as such there would be an uncertainly in recovering that money.

(e) Sixty thousand units of ascorbic acid tablets BP/USP 100 mg had been purchased under 2 batches of 30,000 units each and the following observations are made in this regard.

(i) The first batch of 30,000 units had been received by the Corporation on 15 November 2014. By the time of being identified 25,450 units therefrom as quality failed stock, 18,326 units of them had been sold to patients. Even though, 3,446 units of drugs had been replaced with new stock by the supplier, action had not been taken to recover the cost of balance stock of 22,004 units amounting to Rs.11,687,205 and the fine of Rs.2,921,801 equivalent of 25 per cent thereof.

(ii) As the first 25,450 units out of 30,000 units of drugs had become quality failed, action had not been taken to cancel the 2nd 30,000 units. Despite, the value of Rs.14,609,006 relating to the quality failed 22,004 units had not been recovered, the total amount for the 2nd 30,000 units had been paid to the supplier.

(iii) Even though, 1500 units out of the second 30,000 units received on 11 September 2015 had been quality failed, action had not been taken to recover its cost of Rs.796,710 and the fine of 25 per cent amounting to Rs.199,177 from the supplier even as at 30 March 2018.

(iv) After 3 days from the date of placing the above order for 60,000 units, an another order for 60,000 units of the same drug had been placed with another supplier and purchased the above quantity on 05 January 2016. By 31 January 2016, a balance of 74,370 units were available in the stores. As stocks had been purchased in excess of the monthly average sales, 27,347 units purchased from the first supplier and 501 units purchased from the second supplier, totalling 27,848 units of drugs had expired by 31 December 2017. The total loss incurred by the Corporation due to expiration of drugs amounted to Rs.14,827,925.

4.4 Personnel Administration

The following observations are made.

(a) Number of vacancies existed as at 31 December 2017 amounted to 145. Seven executive level posts and 11 non-executive level posts included therein and belonged to the approved cadre had been appointed on acting basis or covering up duties basis from 18 officers working in another posts, without being recruited on permanent basis. As officers who could be recruited on permanent basis had not been so recruited, the officers of the Corporation who had qualified for those posts had deprived of the opportunity of being appointed to those posts.

(b) Twelve officers on permanent basis and 03 officers on contract basis had been recruited for 15 posts, exceeding the approved cadre.

(c) Two officers had been recruited on contract basis for the post of Manager (Business Resources Planning) since the period of 5 years and the Deputy Manager (Maintenance and Construction) since the period of 6 months which were not in the approved cadre.

(d) Applications were called for the recruitment of the Deputy General Manager (Human Resources and Administration) on contract basis which was a permanent post by a newspaper advertisement published on 28 April 2017 and recruited a retired officer for that post. According to the scheme of recruitment relevant to this post, officers who were in a permanent post of the Corporation with the minimum period of 5 years service in the Grade 01 Management Level relating to the Human Resources and Administration field were eligible to apply for this post. Nevertheless, that qualification had not been included in that newspaper advertisement and as such the permanent officers of the Corporation who had fulfilled that qualification could not apply for the post. Action had not been taken to recruit a permanent officer for this post even by the date of this report.

(e) Even though, a newspaper advertisement had been published on 29 January 2017 to recruit for the post of Deputy General Manager (Technology, Laboratories and Production) fallen vacant since 05 June 2017, no any applicant had been selected due to non-availability of required qualifications and being failed at the interview. Action had not been taken to call for fresh applications, though the period of 11 months had elapsed by 10 April 2018, the date of audit.

(f) According to a newspaper advertisement published to fill the vacancy for the Post of Promotion and Publicity Officer by the Corporation, 191 applications were received, out of which the first and the second interviews had been held for 32 applicants who fulfilled the qualifications. After the second interview, one member of the interview board had made a recommendation that a knowledge in drugs and medical equipment should be required for this post and to revise the existing qualifications in the scheme of recruitment. However, newspaper advertisements had been published in 3 instances without being revised the scheme of recruitment and without inclusion of the required qualifications. It was unable to recruit a qualified officer for this post even by the date of this report.

(g) Newspaper advertisement had been published on 21 May 2017 for the post of Technology Officer (Maintenance and Constructions) and 19 applicants had applied for the post. Even though, it was informed the audit that recruitments had not been made as there were no qualified applicants within the applicants, it was revealed in audit examination that 2 applicants had fulfilled the required qualifications. The Corporation had failed to recruit an officer for this post even by the date of this report.

4.5 Establishment of a fund for the provision for employees gratuity

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In terms of Sri Lanka Accounting Standard 19 even though it was encouraged to prepare an investment plan in respect of retirement gratuity commitment in order to minimise the future liabilities, action had not been taken accordingly.

5. Sustainable Development

5.1 Reaching Sustainable Development Goals

As the Corporation was unaware about the circular No.NP/SP/SDG/17 dated 14 August 2017 issued by the Secretary to the Ministry of National Policies and Economic Affairs and the year 2030 agenda on United Nations Sustainable Development, action had not been taken to identify Sustainable Development goals related thereto, targets, turning points to reach those targets and indices for the measurement of reaching those targets.

6. Accountability and Good Governance

6.1 Procurement and Contract Process

6.1.1 Procurements

The following observations are made.

(a) A Master Procurement Plan and a procurement time table had not been prepared in respect of medical supplies and other assets purchased by the Corporation for sale in terms of Government Procurement Guideline 4.2.

(b) According to the Government Procurement Guideline, the Corporation had purchased 05 photocopy machines, costing Rs.1,236,200, 02 fume hoods costing Rs.1,605,400, 505 pairs of foot-wear costing Rs.860,131, 04 name boards costing Rs.475,886, 61,000 rolls of thermal papers costing Rs.2,695,163, an Automatic Titrator costing Rs.1,477,975 and 2 refrigerators costing Rs.830,000 by following shopping method.

The following observations are made in this connection.

(i) A suitable specimen stated in the standard bid calling documents had not been used in terms of guideline 5.3.1 of the Government Procurement Guidelines and regular agreements had not been entered into in terms of guideline 8.9.1 (b).

(ii) Action had not been taken to obtain a performance bond in respect of 5 photo copy machines in terms of guideline 5.4.10 (b) of the Government Procurement Guideline. Even though, the bidder who had presented the lowest bid had not presented the annual cost of service and maintenance, disregarding that and without being comparatively evaluated the annual cost of service and maintenance, the bidder who had presented the minimum bid had been selected as the successful bidder, after comparing only the prime cost.

(iii) As formal agreements had not been entered into and, conditions regarding demurrage charges had not been included in the bid documents, demurrage charges could not be recovered from the supplier.

(iv) As the maintenance and services had not been included in the bidding documents in calling for bids for the purchase of 5 photo copiers and the automatic titrator, maintenance and services had to be carried out under any charges determined by the relevant Company.

(v) A total cost estimate, including all related expenses had not been prepared in respect of procuring the supply and installation of hoardings for the Anuradhapura Osusala in terms of guideline 4.3.1 (a) of the Government Procurement Guidelines. In addition, action had not been obtained to get a performance bond, a warranty certificate for lightening and installation of hoardings and the prior approval of the Technical Evaluation Committee and the Procurement Committee for art works presented by the supplier before being supplied the hoardings.

(c) The following observations are made in respect of the purchase of 15,000 units of tolbutamide tablets BP/USP 500 mg.

(i) Bids had been called for the supply of this 15,000 units of drugs on 26 February 2014. As the supplier who had presented the lowest bid had not presented a bid bond, it was decided to award the contract to the supplier who had presented the second lowest bid. Even though, an acceptance letter had been sent to the bidder who presented the second lowest bid, the bidder had not accepted it. Accordingly, the bid bond of Rs.400,000 of this bidder had to be encashed. As action had not been taken accordingly the bid bond had expired on 22 October 2014.

(ii) As the contract awarded to the second lowest bidder had not been accepted, the contract had been awarded on 20 August 2015 to the bidder who had submitted the lowest bid which was first rejected due to non-rendition of a bid bond contrary to the guideline 7.8.4 of the Government Procurement Guidelines. That bidder had not obtained the registration of the National Drugs Monitoring Authority as well, even up to the date of awarding the contract in terms of conditions stated in the bid documents.

(iii) According to the requirement of this drug, 9,500 units, the total cost of which amounted to Rs.11,049,640 would have been supplied by November 2014. However, more than a period of 17 months from 26 February 2014 to 20 August 2015 had been taken for the procurement process and as such the stock of drugs had been received only on 05 January 2016. Due to delay in the supply of drugs, stock of drugs during the period of 7 months from June 2015 to 05 January 2016 had exhausted. As a result of taking for a long period for the procurement process, the non-supply of drugs during the saleable period and the supply of drugs in excess of the requirement during the period of lesser sales, 560 units of drugs costing Rs.700,308 had expired. In addition, 156 units of drugs costing Rs.195,086 had been quality failed and as such the Corporation had incurred a loss of Rs.895,394. Only a sum of Rs.320,458 thereof had been recovered from the supplier during the year 2018.

(d) Action had not been taken to recover the demurrage charges of Rs.20,255,000 in terms of the agreement entered into with the supplier for the purchase of 30,000 units of formoterol fumarate and budesonide dry powder capsules (foracort – DP Caps 400) drug.

6.1.2 Deficiencies in contract administration

The following observations are made.

(a) The following observations are made in respect of the contract for the construction of a new building at Rajya Osusala, Colombo 07, the contract value of which was Rs.106,305,300.

(i) Contingency provisions for post contract activities had not been included in the total cost estimate in terms of guideline 4.3.1 (c) of the Government Procurement Guideline.

(ii) Even though, the performance bond produced by the contractor had elapsed on 24 February 2016, action had not been taken to get the validity period of performance bond extended, even by 19 April 2018, though construction works had not been completed, in terms of guideline 5.4.8 of the Government Procurement Guidelines.

(iii) A sum of Rs.6,824,841 had been paid to the contractor for additional works done by the contractor without the approval of the Procurement Committee and the total cost of those unapproved additional works, including the cost of Rs.15,652,564 to be further incurred for the completion of these works amounted to Rs.22,477,405. As a result of doing additional works without approval and non-availability of required provisions, construction works had been stopped since the date of 26 January 2016.

(iv) According to the contract agreement, the construction works should have been completed by 29 January 2015. Nevertheless, the Corporation had failed by to get the incompleted works, partly completed works and the additional works valued at Rs.21,283,641, done even by 19 April 2018 and the period of delay had been more than 3 years.

(v) An electric lift, which was not in compliance with the required specifications, the contract value of which amounted to Rs.4,010,742 had been installed in the building not completed the works. Even though a sum of Rs.5,732,000 had been paid to the contractor for 24 air conditioner machines, information about the warranty period of those machines was not made available for audit.

(b) Action had not been taken to keep a record relating to the issue of bid documents, appoint a Committee for bid opening and to record bid opening activities in a specimen form in terms of guidelines 6.1.4, 6.3.3, 6.3.6 and 5.3.11 respectively of the Government Procurement Guidelines, in the procurement of a generator for an Osusala valued at Rs.6,872,500. After being expired the bid bond on 06 September 2016 all the activities of the procurement process had been commenced.

6.2 Tabling the annual reports

The annual report for the year 2016 had not been tabled in Parliament even up to 20 June 2018 and the draft annual report prepared for the year 2017 had not been presented to audit along with the financial statements.

7. Systems and Control

Weaknesses 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 weaknesses in the following areas of control.

Areas of Systems and Control	Observations
(a) Operational control of the Osusals	Action had not been taken sufficiently to minimize losses having been verified the reasons therefor.
(b) Personnel Administration	Action had not been taken to fill the vacancies properly.