

State Pharmaceutical Manufacturing Corporation – 2018

1.1 Qualified Opinion

The audit of the financial statements of the State Pharmaceutical Manufacturing Corporation of Sri Lanka (“Corporation”) for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 and the Statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018 and the Finance Act No. 38 of 1971. My comments and observations which I consider should be reported to the Parliament appear in this report.

In my opinion, except for the effects of the matters described in the paragraph 1.5 of this report, the financial statements give a true and fair view of the financial position of the Corporation as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for Qualified Opinion

My opinion is qualified based on the matters described in the paragraphs 1.5 of this report. I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Corporation’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Corporation or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Corporation’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Corporation is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Corporation.

1.4 Auditor's Responsibility for the Audit of Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Corporation to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the

presentation of information to enable a continuous evaluation of the activities of the Corporation and whether such systems, procedures, books, records and other documents are in effective operation;

- Whether the Corporation has complied with applicable written law, or other general or special directions issued by the governing body of the Corporation;
- Whether the Corporation has performed according to its powers, functions and duties; and
- Whether the resources of the Corporation had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

1.5 Financial Statements

1.5.1 Non-Compliance with Sri Lanka Accounting Standard

Non - compliance with reference to the Standard	Management Comment	Recommendation
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(a) According to the paragraph 31 of the Sri Lanka Financial Reporting Standard 7, information relating to the nature and the quantity of the risk which can be occurred from the financial instruments at the end of the reporting period had not been disclosed for the convenience of users of the financial statements.	Actions to be taken to rectify in the financial statements for the coming year.	Actions should be taken as per the Sri Lanka Financial reporting Standard.
(b) According to the paragraph 110 of the Sri Lanka Financial Reporting Standard 15, policies for recognition of revenue generated from agreements entered into with costumers should be disclosed. However policies for recognition of revenue generated from the agreements entered into with joint ventures of which the Corporation was a related party and drug distributors had not been disclosed.	Actions to be taken to disclose the revenue recognition policy in the financial statements for the coming year.	-do-

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| (c) | According to the paragraph 32 of the Sri Lanka Accounting Standard 1, assets and liabilities should not be offset unless required or permitted by an accounting standard. However the debit balance of Rs.57,212 remained in the trade creditors account (general)as at 31 December 2018 had been offset to the credit balance of Rs.587,189,088 as at that date and shown in the financial statements. | Actions to be taken not to offset the assets and liabilities in preparing financial statements for the coming year. | Actions should be taken as per the Sri Lanka Accounting Standard. |
| (d) | According to the paragraph 117 of the Sri Lanka Accounting Standard 1, significant accounting policies which are relevant to understand the financial statements should be disclosed. However significant accounting policies such as the policy relating to financial liabilities had not been disclosed in the financial statements. | Actions to be taken to disclose in preparing financial statements for the coming year. | -do- |
| (e) | According to the paragraph 30 and 31 of the Sri Lanka Accounting Standard 8, when an entity has not applied a new Sri Lanka Financial Reporting Standard (SLFRS), that has been issued but is not effective, the entity should disclose this fact and known or reasonably estimable information relevant to assessing the possible impact that application of the new SLFRS will have on the entity's financial statements in the period of initial application. However accounting policies for new or amended standards (e g. SLFRS 16 lease rent) that has been issued but is not yet effective had not been disclosed by the Corporation. | Actions to be taken to disclose in the financial statements for the coming year. | Actions should be taken as per the Sri Lanka Accounting Standard. |
| (f) | According to the paragraph 51 of the Sri Lanka Accounting Standard 16, the residual value and the useful life had not been reviewed annually. As a result even though fixed assets at | Actions to be taken to disclose in the financial statements for the coming year. | -do- |

a cost of Rs.222,514,842 had been fully depreciated, they are still in use. Actions had not been taken to revise the estimated error thereon as per the Sri Lanka Accounting Standard 8. Further accounting policy for depreciation had not been disclosed and the policy for removing the carrying value of property plant and equipment had not been disclosed.

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| (g) | According to the paragraph 68 of the Sri Lanka Accounting Standard 19, even though the projected unit credit method should be applied to determine the present value of the employees' gratuity liability, the Corporation had not disclosed in the financial statements whether the said method was used. | Actions to be taken to disclose in the financial statements for the coming year. | Actions should be taken as per the Sri Lanka Accounting Standard. |
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1.5.2 Accounting Deficiencies

Audit Issue	Management Comment	Recommendation
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(a) Shortages of stock of spare parts amounting to Rs.1,983,315 and excess of stock of spare parts amounting to Rs.213,107 which had been revealed in the physical verification had not been taken in to accounts.	Due to the errors and deficiencies occurred in the census of spare parts of the plant and machinery, census of stock was repeated and the correct stock was included into the pronto accounting system. However stock census records were not revised due to a delay.	Financial statements for the coming year should be presented to audit after rectifying the said error.
(b) The stock of packing materials as at 31 December 2018 had been understated by Rs.359,411	Actions to be taken to rectify when preparing financial statements for the coming year.	-do-

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| (c) | The value of the damaged and unusable stock of Rs.929,759 included in the balance stock of packing materials had not been written off against to the profit. Instead, the said value had been taken into accounts as an excess of stock. Further balance stock of packing materials of Rs.358,289 remained as at 31 December 2018 had been written off against to the profit as a shortage of stock. | Although the stock was being marked under a wrong code over a long period, at this time it was entered under the correct code. In such instances, packing material stock was entered under the both codes thus the stock was overstated. It will be corrected in the next year. | Financial statements for the coming year should be presented to audit after rectifying the said error. |
| (d) | Income of sale of raw material had been shown as operating income. Nevertheless cost of sales of raw materials amounting to Rs.2,881,782 had been debited to the trade account. | It will be presented correctly in the next year and the operating profit for the year under review was calculated correctly. | -do- |
| (e) | Although a sum of Rs.1,775,625 incurred for landscaping of the building constructed under the JICA aid should be recognized as a non-current asset, it had been written off against to the profit. | To be corrected next year | -do- |

1.5.3 Receivable Accounts

Audit Issue

Out of the receivable amount of Rs.1,435,228,910 from the Medical Supplies Division as at 31 December 2018, a sum of Rs.4,830,000 had exceeded 2 years.

Management Comment

Since January 2018, actions were taken to get settled the outstanding amount receivable from the Medical Supplies Division as at 31 December 2018. In certain instances provision allocated could not be obtained and proper actions were taken through the Ministry of Health in this regard.

Recommendation

Actions should be taken to get settled the old debt balances

1.5.4 Identified losses

Audit Issue	Management Comment	Recommendation
(a) Six items of raw material stock at a cost of Rs.2,460,251 as at 31 December 2018 had been expired. Actions had not been taken to carry out a proper investigation to identify the parties who were responsible for the loss and to dispose such stock properly and to write off from the books.	Although the life time of raw materials was extended and used, Quality Control Section was informed that the life time of this stock could not be extended. Hence actions to be taken as per the methodology for writing off the expired stocks.	Actions should be taken to identify the parties who were responsible for the losses and to recover the loss as relevant and to dispose the stocks properly and to write off from the books.
(b) An additional cost of Rs.17,567,693 incurred for re manufacturing of drugs due to break down of the production as a result of quality flayers of drugs produced during the year under review and deficiencies of physical nature. Actions had not been taken by the Corporation to get minimized the unfavorable situations occurred in the production process in every year.	Re manufacturing of drugs is carried out following accepted methodologies in accordance with Good Manufacturing Practices of the World Health Organization. Drugs which can be re manufactured and which should be remove from use are identified according to the nature of various technical problems occurred in manufacturing of drug, Those errors can be minimized in a ground of purchasing raw materials from the same suppliers and manufacturing under an invariable description and a method.	Actions should be taken to minimize the decrease of quality of drugs and manufacturing issues.

1.5.5 Writing off from books without a proper approval

Audit Issue	Management Comment	Recommendation
<p>The estimated total cost of the condenser unit of Rs.150,397 which had not been used over the period from 01 October 2011 to 07 August 2019 had been erroneously taken into accounts as Rs.2,957,791. The said value had been written off from the books during the year under review without a proper approval and actions had not been taken to dispose it properly.</p>	<p>The Auto Still machine with the spare part namely Condenser Unit which was received under the JICA aid in the year 1987 was being used until the year 2007, It was attempted to repair due to operation errors , The manufacturing company had terminated production of spare parts up to the year 2013 because the machine was manufactured before the year 1987, Certain spare parts of the machine were used for renovation of other machines. Actions were taken to write off the Condenser unit against to the profit of the year 2018.</p>	<p>Actions should be taken to obtain proper approval before writing off from the books and to dispose properly.</p>

1.6 Non -compliance with Laws Rules Regulations and Management Decisions etc.

Reference to laws, rules, regulations and management decisions etc.	Non Compliance	Management comment	Recommendation
<p>(a) Public Enterprises Circular No. 21 dated 08 January 2004 and the Financial</p>	<p>Contrary to the instructions, 3 out of the 4 motor vehicles belonged to the Corporation of Health, Nutrition and Indigenous Medicine whilst one</p>	<p>These vehicles had to be handed over to external parties for special projects, Daily running charts were not maintained, it was recommended to be</p>	<p>Information relating to the special projects of which the vehicles had been given, who are the external parties and what is the authority</p>

<p>Regulation 103,104,105 and 1646 of the Financial Regulations of the Democratic Socialist Republic of Sri Lanka.</p>	<p>had been handed over to an external party. Daily running charts had not been submitted to the audit for 2 motor vehicles handed over to the Ministry and for the motor vehicle handed over to the external party. Although a motor vehicle handed over to the Ministry had been returned to the Corporation on 26 July 2019, actions had not been taken with respect of the damages occurred to the vehicle as per the Financial Regulation.</p>	<p>removed the Micro vehicle from use because the repair cost is high, Actions had not been taken to reimburse the damage from the insurance company, if it would be done so, a loss may be occurred to the Institute by missing the no claim bonus.</p>	<p>for issuing vehicles to external parties and the running charts should be submitted to audit.</p>
<p>(b) Public Finance Circular No. 438 of 13 November 2009.</p>	<p>Actions had not been taken to dispose properly the stock of raw material at the cost of Rs.23,286,681 which could not be used as at 31 December 2018, finished stock at the cost of Rs.501,986, stock of packing material at the cost of Rs.2,765,657 and fixed assets at the total cost of Rs.53,595,221 and the book value was zero.</p>	<p>Most of the items out of this are identified in the year 2018 and actions to be taken to dispose properly as soon as possible.</p>	<p>Actions should be taken to dispose the assets properly as per the provisions of the Circulars.</p>
<p>(c) Public Administration Circular No. 30/2008 dated 31 December 2008 and the Section 10 of Chapter XXIV of the Establishment Code.</p>	<p>Although the amount of distress loan which can be payable to an officer should be limited to Rs.250,000 a sum of Rs.4,149,980 had been paid to 41 officers during the year 2018 exceeding the said limit.</p>	<p>Distress loan had been paid on the approval of the Board of Directors because the circulars issued only by the Department of Management Services are related to the Corporation.</p>	<p>Until an establishment Code including Administration and Governing Regulations inherent to the Corporation will be prepared and get the approval, Establishment Code of the Democratic socialist Republic of Sri Lanka and the Public Administration Circulars should be applied.</p>

- (d) Paragraph 02-01 of the letter of the Department of Management Services No. DMS/E4/10/4/090/2 dated 09 March 2009 addressed the Secretary to the Ministry of Health
- (i) A monthly transport allowance of Rs.4,700 and Rs.3,000 had been paid since the year 2009 for the executive and non-executive officers without considering the distance they travelled. This allowance had been increased up to Rs.7,000 and Rs.5,000 and paid since the year 2018 according to a decision of the Board of Directors.
- The service shift is in operation since 6.00 a.m. to 10 p.m. The Corporation is located in a place which is not provided transport facilities, Transport allowance is paid with the approval of the Board of Directors for the distance where the employees located.
- Approval of the Department of Management Services should be obtained before implementing decisions of the Board of Directors. Covering approval should be obtained for the payment which had been already paid.
- (ii) Although only a sum of Rs.4,000 can be paid for the members of the staff as an allowance of monthly production incentive, contrary to that requirement, production incentives had been paid to the entire staff since 01 July 2011 subject to a maximum monthly payment of Rs.12,000. Accordingly, a sum of Rs.80,744,739 had been overpaid since the period of July 2011 to 31 December 2018 including the overpayment of Rs.18,024,917 made during the year under review.
- It was mentioned in the letter of the Department of Management Services that norms of the production incentive should be changed, Accordingly, norms were studied by a committee, A proposal for incentives was referred to the Board of Directors on the timely need and in order to promote the production and the Board of Directors approved the proposal and the payment made accordingly.
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2. Financial Review

2.1 Financial Results

The operating result of the year under review amounted to a profit of Rs.251,262,057 and the corresponding profit for the preceding year amounted to Rs.223,907,939. Therefore an improvement amounting to Rs.27,354,118 of the financial result was observed. The main reason for the improvement is increase of income from sales by 46 per cent.

2.2 Trend Analysis of major Expenditure Items

Administration expenditure for the preceding year and the year under review were Rs.204,579,086 and Rs.242,218,982 respectively and the said expenses had increased by 18 per cent during the year under review compared with the previous year. Increase of expenses of provisions for the health insurance scheme by 1314 per cent had mainly affected to this improvement of expenditure.

2.3 Ratio Analysis

Compared with the previous year the gross profit ratio and the net profit ratio of the year under review had reduced by 2.4 per cent and 2.3 per cent respectively and debtors turnover ratio had reduced by 8.3 times and recovering period of debts had increased by 48 days. Operational activities of the Corporation should be accelerated paying attention in this regard.

3. Operational Review

3.1 Uneconomic Transaction

Audit Issue

Although a sum of Rs.283,923 had been paid in the years 2016 and 2017 as consultancy fees for the contract for extension of Quality Control Laboratory, subsequently calling of tenders had been terminated. Hence the cost incurred thereon had become a fruitless expenditure.

Management Comment

The contract for extension of Quality Control Laboratory is terminated according to a decision of Governing Authority.

Recommendation

Administration on contract should be carried out according to a proper plan.

3.2 Management Inefficiencies

Audit Issue -----	Management Comment -----	Recommendation -----
The license obtained from the National Drug Regulatory Authority for manufacturing of Cimetidine Tablets BP 200 mg had expired on 18 May 2012. However actions had not been taken to obtain a new license over a period more than 6 years. Nevertheless 39 millions of tablets of the said drug had been manufactured and sold during the period from 18 May 2012 to 07 March 2019 without a license.	Payment was made on 13 March 2019 for obtaining license. Therefore manufacturing can be carried out.	Actions should be taken as per the National Drugs Regulatory Authority Act No. 5 of 2015.

3.3 Operating inefficiencies

Audit Issue -----	Management Comment -----	Recommendation -----
(a) During the year under review, 4,477 kg of raw material had been purchased at a cost of Rs.9,784,235 in order to manufacture 3 drug items. However it had remained over a period of 07 to 24 months without being used.	Rest of the raw materials can be used for production.	Purchasing plan of raw materials should be prepared based on the marketing plan and the production plan. Expiring should be minimized by purchasing raw materials according to the said plan.
(b) Out of 4 items of drugs which was being manufactured during the year under review, 627 Kg had failed the quality. Hence it had been removed from the production and the loss occurred thereon was Rs.1,341,104.	Identification of low quality drugs in the production process was based only on the observation of employees and there is no other methodology for that, the amount rejected was very low, However after such incident actions were taken to prevent this happening again.	A proper procedure of quality control should be implemented.

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| (c) | Out of the amount of drugs ordered by the Medical supplies Division for the year under review, the Corporation had failed to supply 53.2 million units of 8 categories of drugs at the sale price of Rs.113,987,125 due to unavailability of raw materials, insufficient machine capacity and drugs not being registered in the National Drug Regulatory Authority. | Supply of 7 categories of drugs were delayed due to issues occurred in registration of drugs in the National Drugs Regulatory Authority, complications occurred with the establishment of the National Drugs regulatory Authority had affected to this situation, as a remedial measure this activities were assigned to a separate executive officer and the said issue was settled 100 per cent at the moment, Erythromycin tablets BP 250mg drug was not produced because it is not being used further. | Maximum effort should be put to complete the orders of the Medical supplies Division and to protect the market share |
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3.4 Transactions in Contentious Nature

Audit Issue	Management Comment	Recommendation
A sum of Rs.1,000,000 had been sent to the Director General of Health Services during the year under review for a function which had been held to celebrate the appointment of the Minister of Health Nutrition and Indigenous Medicine to the position of Deputy Chairman of the 143 Executive Committee of the World Health Organization.	Actions were taken as per the request of the Ministry of Health and the approval of the Board of Directors.	Funds should not be incurred for felicitation ceremonies which is an objective extraneous objective from the objectives of the Corporation.

3.5 Delays in Projects or capital works

Audit Issue -----	Management Comment -----	Recommendation -----
<p>(a) The following observations are made relating to the contract of converting the Penicillin Zonal Stores to the Cephalosporin Production Section.</p>		
<p>(i) Mobilization advance of Rs.14,216,622 had been paid to the contractor on 01 February 2017. However period over than 7 months had been taken to hand over the site. Hence the advance had been remained with the contractor more than a period of 4 months as at 06 June 2017. The opportunity cost which had to be incurred to the Corporation was Rs.500,000 approximately.</p>	<p>Handing over the site was delayed because the raw material stored in the building had to be moved to an another place, There was a risk for termination of the contract if the advance was not paid, If it happened, it could not be avoided the increase of prices when calling quotations again.</p>	<p>Contract administration should be carried out according to a proper plan.</p>
<p>(ii) According to the contract agreement, even though the contract should be completed as at 02 March 2017, work had not been completed even up to the 06 August 2019 and the period delayed was 884 days.</p>	<p>Consultancy Institutes for construction of such drug manufacturing building was not in Sri Lanka and the construction was carried out under the then Project Manager, constructions are being carried out giving priority to obtain the approval of the National Drugs Regulatory Authority to manufacture quality drugs. The requirement is production of drugs in accordance with due standards than speeding up construction.</p>	<p>Contract administration should be carried out according to a proper plan.</p>
<p>(iii) Written evidence had not been submitted to audit to be confirmed that extension of period of construction had been properly done or liquidated damages had been recovered.</p>	<p>Conditions were not mentioned in the agreement for recovering liquidated damages.</p>	<p>Conditions for liquidated damages should be included into agreements.</p>

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| (iv) | Contract price had been increased by Rs.3, 710,815 represents 6.8 per cent and consultancy fees had been increased by Rs.977, 542 due to the extension of the period of the contract. | Reasons such as Stores had to be air conditioned and spending 7 months for the procurement procedure were affected. | Contract administration should be carried out according to a proper plan |
| (v) | Certificate for Good Manufacturing Practice which should be obtained for the manufacturing plant before obtaining registration certificate from the National drugs Regulatory Authority for manufacturing of Cephalexin Monohydrate BP 2015 could not be obtained due to non-completion of constructions. | Necessary steps had been taken to produce said drug after completion of construction of the manufacturing plant and obtaining the approval of the Drug Regulatory authority. | - Do - |
| (vi) | Stock of 500 kg of raw material of Cephalosporin Monohydrate BP 2015 purchased in August 2018 at a cost of Rs.4,222,836 could not be utilized. | A decision was taken in the year 2016 to install a new drug zone by the name of Cephalosporin Zone, Simultaneously; tests were initiated by the Formulation Development Division for new drugs. Accordingly the target was to introduce the new drug to the market by the end of 2018, However the target could not be achieved due to the inability of completion of construction and this stock of raw material was purchased for the commencement of production by the end of the year 2018. | Raw material should be purchased according to a realistic plan. |
| (b) | It was revealed that contract administration of the Corporation was in a poor condition due to the reasons such as being selected Consultants of construction and contractors without transparency and without following Guidelines of the Government Procurement Guideline, dates of completion of contract, conditions for recovering liquidated damages not being | Not commented | Contract administration should be carried out according to a proper plan. |

entered into the agreements, continuous changes of initial plans without a proper approval, constructions being carried out without complying with the bill of quantities and plans, Contract files not being maintained properly and a proper supervision not being carried out.

3.6 Procurement Management

Audit Issue -----	Management Comment -----	Recommendation -----
(a) Procurement time table had not been prepared properly in accordance with the master procurement plan for the year under review.	Attention will be paid to prepare the procurement time table without deficiencies.	Actions should be taken as per the Guideline 4.2 of the Government Procurement Guideline and a procurement time table should be prepared for the master procurement plan.
(b) The following observations are made in connection with calling proposals for inviting potential investors to start joint ventures with the corporation, establishment of joint ventures, conducting joint ventures and supply of drugs from such ventures.		
(i) The invitation made to the investors for expression of interest for commencing joint ventures with the Corporation had been published in newspapers on 16 October 2015. However the Cabinet approval for starting joint ventures had not been obtained up to then.	Cabinet approval was requested referring the proposals made for a partnership of the Government and the Private Sector in the year 2015. According to the Cabinet Decision, this action should be preceded in transparency. Hence the invitation for expression of interest was published in October 2015.	Prior approvals should be obtained.
(ii) Documents prepared for submission of proposals for commencing joint ventures with the Corporation had not been approved by the Project Committee and the Cabinet appointed Negotiation Committee respectively.	Documents for submission of proposals were issued to the bidders after opening bids. After receiving proposals, they all were referred to the Ministry. A Negotiation Committee was appointed for studying proposals and to submit for the Cabinet	Actions should be taken as per the Guideline 5.3.1(d) of the Government Procurement Guideline.

Recommendation. A project Committee was appointed by the Department of Public Finance to assist the said committee.

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| <p>(iii) A Committee for opening proposals received for initiating joint ventures had not been appointed as per the Guideline 6.3.3.(a) of the Government Procurement Guideline. Further according to the Guideline 6.3.6 of the said Guideline, a report in connection with opening proposals had not been prepared in the due format. As a result, information relating to the date of opening bids, time, and number of proposals received and the investors who had submitted proposals could not be obtained.</p> | <p>There was no necessity of appointing a Committee for opening proposals because proposals receiving to initiate joint ventures were merely an expression of interest only and there were no financial or technical value.</p> | <p>Actions should be taken as per the Government Procurement Guideline.</p> |
| <p>(iv) Although corporation had been entered into agreements with 17 investors for commencing joint ventures, 10 investors out of that 17 had not submitted Expression of Interest.</p> | <p>Bid documents were issued to the bidders who had submitted proposals later as per the recommendation of the official Committee.</p> | <p>Actions should be taken as per the Government Procurement Guideline.</p> |
| <p>(v) According to the recommendation of the Cabinet Appointed Official Committee, quality control, management and technical assistance of the production process of the investor who had agreed for joint venture should be supplied by the Corporation and for that purpose, 10 per cent of the shares of that investor's business should be issued to the corporation. However, 12 items of drugs had been purchased at Rs. 1,063,106,416 from 2 private companies who had not issued share to the Corporation and had been sold to the Medical Supplies Division. Further quality control, management and technical assistance relating to the production of the said 2 private companies had not been supplied by the Corporation in any way.</p> | <p>Approval for purchasing of shares was received in the meeting of the Board of Directors held on 14 June 2019 and agreements for purchasing of shares to be signed in future</p> | <p>Actions should be taken as per the recommendations of the Official Committee appointed by the Cabinet.</p> |
| <p>(vi) Cost sheets for each drug submitted by the investor who had agreed with for the joint venture had not been certified by an</p> | <p>Cost sheets are checked by the Price Committee including the Chief Accountant of the Ministry.</p> | <p>Cost sheets of the joint venture should get certified by an</p> |

independent party.	independent party in writing.	
(vii) Profit margin had been obtained by the Corporation and the joint venture separately. As a result, a joint venture had not been built up and the objective for supplying of drugs at a minimum cost had not been fulfilled as expected.	According to the Cabinet approval, the joint venture carried out the relevant production was entitled to a 20 per cent profit margin and the State Pharmaceutical Manufacturing Corporation was entitled to add 6 per cent service charge on the said price.	Actions should be taken as per the recommendations of the Official Committee appointed by the Cabinet.
(viii) According to the recommendation of the official committee, sale price should be determined by adding 20 per cent profit margin to the production cost of the pharmaceutical and surgical consumables of the production of the investor who had agreed for the joint venture. However contrary to the said recommendation, there were instances of determine the sales price by adding more than 20 per cent of profit and service charges to the cost of pharmaceutical and surgical consumables. Such instances are given below.		
❖ The total production cost of 8 items of drugs produced by investors during the year under review was Rs.297,522,198. It had been supplied to the Corporation at the invoice value of Rs.342,096,987 by adding Rs.44, 574,789 as profit to the cost. The Corporation had sold to the Medical supplies Division at Rs.362,640,664 by adding service charges of Rs.20,543,677 to the invoice value. Profit margin of 14.98 per cent out of the total cost of 8 drugs by the investor and service charge of 6 per cent of the invoice value by the Corporation had been earned. Accordingly the sale price had been determined by adding 21.89 per cent of the cost as profit and service charges.	According to the Cabinet approval, the joint venture was entitled to a 20 per cent profit margin and the State Pharmaceutical Manufacturing Corporation was entitled to add 6 per cent service charge on the said price	Actions should be taken as per the recommendations of the Official Committee
❖ According to the recommendation of the Official committee, joint ventures should be established only with the	According to the paragraph 3.15.2 of the joint venture agreement, in an event of which the product	According to the National Drug Regulatory Authority

companies of which pharmaceutical and medical instruments are manufactured. However it had been entered into an agreement to establish a joint venture with a private company which had only been distributed surgical consumables without being manufactured. According to the Section 82 (1) of the National Drug Regulatory Authority Act No.05 of 2015, this private company had not obtained the registration of the National Drug Regulatory Authority for manufacturing of medical instruments. The total production cost of the 473,800 units of Crape Bandage 7.5cm x 4.5m including the value added tax and Nation Building Tax was Rs.42,349,476. It had been supplied to the Corporation at invoice value of Rs.48,794,100 by adding profit margin of Rs.6,444,624. The Corporation had sold to the Medical Supplies Division at Rs.53,871,060 by adding service charge of Rs.5,076,960 to the invoice value. Out of the total cost of this item, profit margin of 15.22 per cent by the investor and service charge of 10.4 per cent of the invoice value by the Corporation had been earned. Accordingly the sale price had been determined by adding 27.2 per cent of the cost as profit and service charges.

could not be supplied by a producer, he is allowed obtain the said product by other local producer and supply. Accordingly, the company which the manufacturer of surgical consumables, licensed distributor and the corporation, entered into a tripartite agreement on May 30, 2019. The registration permits of the National Drug Regulatory Authority was obtained by the licensed distributor to order medical instruments.

Act No. 05 of 2015, it should not enter in to agreement for joint ventures with suppliers who had not registered and obtained licenses.

Actions should be taken as per the recommendations of the Official Committee appointed by the Cabinet

(ix) Out of the drugs which were supplied from joint ventures during the year under review, quality had been tested in only one item of drugs.

According to the agreements entered into with joint ventures, even though random samples were tested, it was not tested 100 per cent, Laboratory facilities of the Corporation are being developed in technical side and in human resources as well, after the completion of those activities all tests can be carried out in maximum than the present.

System should be arranged by the Corporation as possible as to obtain a high confirmation of the quality of the drugs and medical instruments supplied.

- (c) A sum of Rs.13,860,000 had been paid to the Salacine Rupawahini Institute to fix 300 televisions for Pacidol promotion activities. Contrary to the Guideline 5.4.4 (i) of the Government Procurement Guideline, a sum of Rs.11,380,446 had been paid to the said institute in two instances as 70 per cent advance. An advance security or performance bond had not been obtained.
- The Cabinet of Ministers had made it mandatory to hand over the trade advertisements and advertising programmes of all Ministries and institutions under them to the Salacine Rupawahini Institute. Hence according to the agreement entered into with the said institute, 70 per cent advance was paid, Performance bond was not obtained because the risk of the contract not being completed was very low due to the fact that the Salacine Rupawahini Institute is a Government Institute.
- Actions should be taken as per the Government Procurement Guideline and warranty certificates should be obtained as per the agreements.

3.7 Deficiencies in Contract Administration

Audit Issue -----	Management Comment -----	Recommendation -----
(a) The following observations are made in connection with two contracts for construction of steel structural warehouse which the contract value of Rs.16,007,188 and the flyover which the contract value of Rs.15,018,184.		--
(i) A Bid Opening Committee had not been appointed and the process relating to opening bids had not been reported in a due format.	For the time being, a common Bid Opening Committee was appointed, The process for opening bids was reported in a record book, but any other format was not maintained.	Actions should be taken as per the Government Procurement Guideline.
(ii) It had been taken 19 weeks and 26 weeks respectively for selecting the contractor. The over spent time were 15 weeks and 22 weeks.	Reason for the delay was, after the submission of the report of the Technical Evaluation Committee, it was taken a lot of time to grant the approval of the Procurement Committee.	-do-
(iii) A performance bond had not been obtained from the contractor who had been selected for the construction of structural warehouse.	A performance bond was not obtained for the structural warehouse	-do-
(iv) Although the construction of steel	Deficiencies will be corrected and	Contracts should

structural warehouse had been completed as at 31 December 2018, it was observed in the physical verification carried out on 25 July 2019, the upper floor of the building could not be used because the inflow of rain water from the gutters.

taken into use by August 2019.

be carried out under a proper supervision

(v) Payments for all raw materials purchased by the contractor for the construction of steel structural warehouse had been made to the contractor. Out of that, a stock of raw material was left without calculating the value. However the said stock had not been taken into accounts.

The balance of raw material left is decided to be used for the flyover.

The balance stocks of raw material should be taken in to accounts and should be issued where necessary.

(vi) Constructions of the flyover had been commenced on 05 February 2019 after a delay of 07 months instead of the date of 05 July 2018 of which the constructions should be commenced.

It is scheduled to be constructed the empty plastic bottles store building and the flyover by the same contractor in the Corporation premises. Considering the disturbances which can be occurred to the day to day activities, the construction of flyover was delayed until the construction of empty plastic bottle store was completed.

Actions should be taken according to a proper plan.

(b) The following observations are made for the construction of four storied building of which the total contract value of Rs.82,994,567.

(i) Three items of door frames, doors and windows and the steel hand rail at the total contract value of Rs.3,384,500 had been constructed less than the amount mentioned in the plans and bills of quantities. Nevertheless the total contract value had been paid without considering the matter mentioned above.

It had to be fixed the doors available in the market due to unavailability of doors equal to the doors fixed in the Corporation. Substitutions available in the market had to be used because the estimated section sizes of aluminum items were not available in the market. After examination of measurements taken with the quantity survey, actions to be taken to pay the final bill after recovering the defects.

Payments should be made after the proportional deductions which should be made for the constructions less than the measurements of estimated plans and bills of quantities.

(ii) The building of which constructions had been completed by incurring the total amount of Rs.118,589,409 since the year 2016 and opened as at 12 October 2018 had

Although the construction of the building was completed it could not be taken into use due to the delay of fixing air condition machines

Actions should be taken to get utilize the building as per a proper plan.

been remained idle without utilizing for any fruitful purpose even up to 20 August 2019, due to the reasons such as air condition machines not being fixed and there were deficiencies of constructions. and purchasing furniture.

(c) The contract for modernization of the building which had been purchased at Rs.88,000,000 in the year 2017 in order to establish a laboratory and a training school had been awarded to a sum of Rs.33,468,608 on 08 May 2018. A sum of Rs.22,856,750 had been paid to the contractor as at 02 August 2019. The following matters were revealed in this regard.

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| (i) | Detailed drawings relating to type of doors and type of windows of four floors had not been submitted to audit. | Although details of work for doors and windows were submitted with bid documents, substitutions were submitted as per the quantities available in the market and subsequently it was approved. | All detailed plans relating to the contract for constructions should be submitted to audit. |
| (ii) | According to the work description of construction of the roof, gutters and drainage pipes had not been fixed. However the total contract value of the said item of Rs.531,037 had been paid. | An additional payment had to be made for the used wood bigger in extent, when the prices submit for the said wood total amount can be paid for the said item. | Actions should be taken to get fixed the gutters and drainage pipes or get refunded from the contractor or from the parties who had recommended the payment. |
| (iii) | Although the length of the iron net fence which had been constructed as to be covered a part of the land of which the building located was 132 feet, a sum of Rs.219,455 had been over paid erroneously mentioning that the length of the fence constructed was 394.5 feet. | It was a mistake taken place in entering measurements relating to the item. Actions to be taken to rectify the said error in the next bill. | Actions should be taken to get refunded the over payments from the contractor or from the parties who had recommended the payments. |
| (iv) | Although the iron net fence had been constructed non – complying with the details mentioned in the bill of quantity, without considering that, the total value of the item of Rs.329,810 had been paid. | -do- | -do- |

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|--------|--|--|--|
| (v) | The capacity of the well which supplied the drinking water to the building was not sufficient and that well located near by the toilet and the sewage system and the sewage canal. Quality of the water had not been tested. | It was expected to recruit a crew consists with 30 students to the training school in the first stage, It is expected to be fixed a small size reverse osmosis system to supply of required water. | Actions should be taken to supply pure drinking water. |
| (vi) | The building had not been air conditioned and the Certificate of Conformity had not been obtained from the relevant Local Government Institute for the construction and modernization. | This item was removed because the cost was very high and actions to be taken to obtain the Certificate of Conformity for the building. | Conditions relating to the plan which had been approved by the Pradeshiya Sabha should be implemented. Certificate of conformity should be obtained. |
| (vii) | The non-operational electric elevator remained in the building had been closed as not to be used and there was a requirement of an electric elevator for the 4 storied building. | It was taken a decision to close the access of the said electric elevator in site meetings. | An electric elevator should be supplied for the building. |
| (viii) | Although lying of internal data cable and telephone lines had been included in the initial plans for modernization of the building, only the conduits had been fixed. | It was taken a decision not to lay the internal data cable in site meetings. | Internal data cables and telephone lines should be laid as per the requirement. |
| (ix) | Although the contract had been completed and handed over, a pre plan or pre arrangement could not be seen in the Corporation to fulfill other requirements to establish a laboratory and a training school. | Paper notices were published for recruiting students to initiate the training school, Actions to be taken to prepare necessary plans under the assistance of a consultancy service company for the laboratory, Only the infrastructure facilities were established for using the laboratory after commencing the production of proposed factories. | Actions should be taken to utilize the building completely according to a plan. |

- (d) In the contracts implemented by the Corporation, specific conditions for completion of contracts or recovering liquidated damages had not been included into agreements entered into with the consultants and contractors
- The commencing date was mentioned in the contract awarding letter.
- Specific conditions for the date of completion of the contract and the liquidated damages recoverable should be mentioned in the agreements entered into with contractors.

4. Accountability and Good governance

4.1 Annual Action Plan

Audit issue	Management comment	Recommendation
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(a) Performance indicators of the activities included in the corporate plan which had been prepared by the Corporation for the period of the year 2018 to the year 2022 had not been mentioned specifically, adequately and in a measurable manner. As a result, the progress of 25 activities included in the action plan prepared for the year under review could not be evaluated specifically.	In connection with the activities included in the action plan for the year under review, only the part of the work which can be fulfilled relating to each activity was fulfilled.	Actions should be taken according to the Public Enterprises Circular No PED/12 dated 02 June 2003 and paragraph 5.1.2. of the Public Enterprises Guideline for Good Governance.
(b) The Corporation had failed to fulfill 27 activities included in the action plan for the year under review during the year under review. Progress of further 18 activities had been mentioned only as a percentage. Hence the progress of the fulfillment of such activities could not be measured specifically.	-do-	-do-