State Pharmaceuticals Manufacturing Corporation of Sri Lanka - 2013

The audit of financial statements of the State Pharmaceuticals Manufacturing Corporation of Sri Lanka for the year ended 31 December 2013 comprising the statement of financial position as at 31 December 2013 and the statement of 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 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 the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the State Pharmaceuticals Manufacturing Corporation of Sri Lanka as at 31 December 2013 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 Non-compliance with Laws, Rules, Regulations and Management Decisions

Non-compliance with the following laws, rules and regulations were observed.

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a) Section 10 of the Value Added Tax Act, No. 14 of 2002	Even though this tax should not be paid to the companies not registered with the Commissioner General of Inland Revenue for the Value Added Tax, a sum of Rs.64,680 had been paid in the year 2013 as Value Added Tax to a company not so registered.
(b) Circular No. PED 57 dated 11 February 2011 of the Department of Public Enterprises	Donations and sponsorships amounting to Rs.1,300,000 had been granted by the Corporation in 03 instances during the year under review to Non-Governmental Institutions without the approval of the Minister of Finance and Planning.
(c) Public Finance Circular No. GF/PE/6 dated 31 January 2000	Contrary to the circular instructions, Pay As You Earn Tax amounting to Rs.1,018,647 in respect of the year under review had been paid from Corporation funds on behalf of the employees. Even though action had not been taken to recover that amount from the employees, action had been taken with effect from August 2014 for the recovery of the tax from the employees.
(d) Letter No. DMS/E4/10/090/2 dated 09 March 2006 of the Department of Management Services of the General Treasury addressed to the Secretary to the Ministry of Health	

(i)	Paragraph No. 02-01	Even though the transport allowance determined on the basis of distance should be paid to all Executive and Non-executive employees, monthly transport allowances of Rs.4,700 and Rs.3,000 respectively had been paid to all employees from the year 2009 to the 2013.
(ii)	Paragraph No. 02.01(i)	Transport allowance had been paid to the employees residing close to the routes on which vehicles had been deployed for transport facilities.
(iii)	Paragraph No. 02-02	A monthly production incentive allowance of Rs.12,000 had been paid with effect from 01 July 2011 to the entire staff except the Chairman without the approval of the Department of Management Services. Even though the maximum production incentive payable in the year under review to the total staff of 218 amounted to Rs.10,464,000 a sum of Rs.18,707,055 had been paid. As such an overpayment of the production incentive amounting to Rs.8,243,055 had been made.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Corporation for the year ended 31 December 2013 had resulted in a pre-tax net profit of Rs.329,968,881 and that as compared with the pre-tax net profit of Rs.117,136,719 for the preceding year indicated an increase of Rs.212,832,162. Nevertheless, the net profit of the Corporation for the year under review before taking into account the non-operating income of Rs.28,059,081 inclusive of the interest income of Rs.25,314,785 on the Treasury Bills, amounted to Rs.301,909,800. The net profit for the preceding year before taking into account the non-operating income of Rs.34,251,670 , amounted to Rs.82,885,049. Accordingly, the net profit before taking into account the non-operating income as compared with the net profit for the preceding year before taking into account the non- operating income indicated an increase of Rs.219,024,751 or 264.3 per cent.

3.2 Analytical Financial Review

The following observations are made.

(a) The gross profit ratio of 22.0 per cent for the year 2013, as compared with the gross profit ratio of 15.4 per cent for the year 2012 indicated an increase of 42.8 per cent.

(b) The net profit ratio of 10.7 per cent for the year 2013 as compared with the net profit ratio of 7.0 per cent for the preceding year indicated an increase of 52.9 per cent.

(c) The current ratio of 7.9 per cent and the quick ratio of 5.9 per cent that prevailed in the year indicated that the surplus working capital had not been effectively deployed.

(d) The debtors turnover ratio for the year under review as compared with the preceding year had deteriorated by 1.1 per cent and the debt collection period had increased by 19 days. Thus it was observed that the debt collection had not been properly managed.

3.3 Legal Action Instituted against or by the Corporation

The following observations are made.

(a) Employees of the Corporation had instituted legal action in Courts against the Corporation demanding the reimbursement of interest on the Housing Loans of employees.

(b) The Corporation had lodged an appeal in the Courts against the judgment of a case filed by an employee of the Corporation demanding compensation.

(c) The Corporation had instituted legal action for the recovery of a sum of Rs.570,257 receivable from a debtor since the year 2007.

4. Operating Review

4.1 Performance

The following observations are made.

(a) Manufacturing Activities

The comparative information on the drugs manufactured by the Corporation during the year under review and the preceding 04 years had been as follows.

Year	Number Varieties of Drugs Manufactured	Units Manufactured (Millions)
2009	38	1,195.2
2010	38	1,614.1
2011	37	1,796.4
2012	40	1,920.2
2013	40	2,005.1

The following observations are made in this connection.

(i) The increase in the ratio of manufacture of Units of drugs in the year 2012 had been 6.8 per cent and that as compared with 4.4 per cent for the year under review, indicated a deterioration of 2.4 per cent.

(ii) The total product of 40 varieties of drugs in the year 2012 amounting to 1,920.2 million units as compared with the total product of those 40 varieties in the year under review amounting to 2,005.1 million units indicated an increase of 84.9 million units of drugs manufactured in the year under review.

(iii) The contribution of 4 varieties of drugs out of the 40 varieties manufactured in the year under review to the total product amounted to 0.09 per cent, and 1,027.73 million units or 51.24 per cent of the total product represented the contribution of 5 varieties of drugs.

(iv) The number of items of drugs under research level from the year 2005 to 2013 had been 07. Even though a sum of Rs.1,186,200 had been spent on those researches during periods ranging from 03 to 08 years, those drugs had not been introduced to the market.

(b) Marketing and Pricing

The information on the marketing of drugs by the Corporation during the year under review and the preceding year is given below.

	Marketing of Drugs		Value	
	2013	2012	2013	2012
	Million Units	Million Units	Rs.Millions	Rs.Millions
State Pharmaceuticals Corporation	13.5	492.4	9.6	412.4
Medical Supplies Division	1,507.1	1,203.9	1,412.1	1,000.7
Export	-	3.8	-	1.4
Other Distributors	478.5	-	519.4	-
Total	1,999.1	1,700.1	1,941.1	1,414.5

The following observations are made in this connection.

(i) The Corporation had sold 75.39 per cent of the total sales of the year under review to the Medical Supplies Division and the sales income earned therefrom represented 72.7 per cent of the total sales income.

(ii) The sale of drugs through Distributors had been resumed during the year under review and 478.5 million units of drugs had been sold to 45 Distributors for Rs.519.4 million by allowing discounts amounting to Rs.52.8 million.

(iii) Out of the total sales of units of drugs and the sales value of 45.9 per cent and 38.7 per cent respectively represented 32 varieties of drugs while 54.1 per cent of sales of units of drugs and 61.3 per cent of the sales value represented 08 varieties of drugs.

(iv) The Corporation could not supply during the year under review an order for 36.50 million units of 05 varieties of drugs valued at Rs.47.27 million due to reasons such as the technical defects in the products and the inability to obtain raw materials conforming to standards.

(v) The gross profit for the year 2013 as compared with the year 2012 had increased by Rs.208.8 million or 95.56 per cent while the gross profit margin for the year 2013 as compared with the year 2012 had increased by 42.39 per cent.

(vi) Instead of the State Pharmaceuticals Corporation which functioned as the permanent Distributor of the Corporation during the year 2011 and 2012, the Corporation had commenced the distribution of drugs through Distributors including the State Pharmaceuticals Corporation from the year 2013. In the supply of 23 varieties of drugs to those Distributors, the prices applied to the State Pharmaceuticals Corporation with a low profit margin of 15 per cent had been applied in the year under review without carrying out a market survey or price survey in determining their prices.

(vii) In view of the bonus issues system implemented by the Corporation with effect from 01 January 2013 for the varieties of drugs, namely Amoxicillin Tab 125mg, Parasitamol Tab 500mg and Amoxicillin Cap. 500mg on which prices had been determined at a low margin 15 per cent on cost, the profit margins of those drugs had reduced to ranges between 8 per cent to 1 per cent.

4.2 Management Deficiencies

The following observations are made.

(a) Drugs, raw materials and packing materials costing Rs.2,307,359 had been destroyed during the year under review due to rejection, damage and non-issue.

(b) Raw materials costing Rs.13,202,663 purchased for manufacture of drugs had not been used for manufacture due to reason such as rejection by machines, prescription defects, non-conformity with specifications, discoloring and expiry of validity.

(c) Even though the manufacture of the drug Chloramphenical had been stopped in the year 2011 due to technical weaknesses in the manufacture, out of the Chloramphenicol BP2010 raw materials imported in the years 2011 and 2012, a stock of 1,102.7 kilogrammes valued at Rs.6,107,917 remained in the stores of the Corporation. Out of that, the validity of 984 kilogrammes of raw materials valued at Rs.5,325,210 had expired in July 2014 and the validity of 18.7 kilogrammes of raw materials valued at Rs.78,287 had expired in March 2014. Action had not been taken for the rectification of technical defects in the manufacture and the Corporation had incurred a financial loss of Rs.5,403,497 from the 1,002.7 kilogrammes of raw materials referred to above.

4.3 Operating Inefficiencies

The following observations are made.

(a) The bid for the supply and installation of 09 work tables for the improvement of the laboratory had been awarded on 25 March 2011 for Rs.1,365,969 inclusive of the Value Added Tax to the bidder who made the lowest price and advances amounting to Rs.1,285,780 had been paid in the years 2012 and 2013. Even though the work tables had been supplied on 19 February 2013, those could not be installed by the supplier as the goods kept in the area selected for installation had not been removed. As such the expenditure incurred remained unproductive and the advances paid remained without being settled.

(b) The Performance Bond valued at Rs.8,666,375 in relation to the purchase of the new tablet production machine expired on 26 March 2013 and action had not been takes for extending the validity. In addition the Performance Bond had been misplaced due to lack of an adequate control system.

4.4 Transactions of Contentious Nature

The following observations are made.

(a) The value of raw materials used in the manufacture and rejected / destroyed raw materials and packing materials amounting to Rs.2,724,726 had been written off against, the profit during the year under review in accordance with the decisions of the Board of Directors No. 35/13 dated 21 March 2013, No. 18/13 of 22 February 2013 and No.116/13 dated 23 October 2013.

(b) A sum of Rs.25,000 had been paid 17 December 2013 to an Assistant Commissioner of Labour without calling for quotations for checking the legal short-comings in the Manual of Human Resources and Administrative Procedures prepared by an Assistant Manager of the Corporation.

4.5 Idle or underutilized Assets

The following observations are made.

(a) The test check of the unused assets valued over Rs.1,000 each revealed that 115 units of 62 items of production machines, computers and accessories, furniture, air-conditioners and finger print machines costing Rs.18,606,953 had been remaining in various Divisions of the Corporation since the year 2009 to March 2014 due to damage caused or non-use as at 31 December 2013.

(b) Action had not been taken to repair and use 34 items of assets costing over Rs.5,000 totalling Rs.11,501,315 or for their disposal in terms of the Public Finance Circular No. 353(5) of 03 January 2003 if those cannot be made use of.

4.6 Staff Administration

Thirty six vacancies comprising 14 posts in the Staff Grades and 22 posts in the Non-staff Grade had not been filled in the year under review.

5. Accountability and Good Governance

5.1 Internal Audit

The attention of the Internal Audit Unit had not been paid for the purchase of raw materials and unusable machinery due to damage or non-use.

5.2 Budgetary Control

The budget for the year 2013 approved by the Board had been revised on 16 August 2013.

Despite such revision the variances in the budgeted expenditure and the actual expenditure under 03 Heads ranged between 25 per cent to 87 per cent and the variances in assets and liabilities ranged from 17 per cent to 1780 per cent. Thus the budget had not been made use of as an effective instrument of financial control.

5.3 Tabling of Annual Reports

The Annual Report for the year 2012 had not been tabled in Parliament even by the end of August 2014.

6. Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Chairman of the Corporation from time to time. Special attention is needed in respect of the following areas of control.

(a) Budget
(b) Taxes
(c) Manufacture and Pricing of Drugs
(d) Debtors
(e) Fixed Assets Management
(f) Stocks
(g) Human Resources Management