

**State Pharmaceuticals Corporation of Sri Lanka -2011**

1. **Financial Statements**

1.1 **Qualified Opinion**

In my Opinion, except for the effects of the matters described in paragraph 1.2 of this report the financial statements give a true and fair view of the financial position of the State Pharmaceuticals Corporation of Sri Lanka as at 31 December 2011 and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting standards.

1.2 **Comments on Financial Statements**

1.2.1 **Accounting Deficiencies**

The following observations are made.

- (a) Due to non-accounting of debit notes valued at Rs.208,143,509 relating to the previous 5 years and the year under review in respect of drugs supplied to the Director General of Health Services , the debtors by that amount and credit sales by Rs.19,890,083 had been understated in the accounts.
- (b) Stock in transit belonging to the Director General of Health Services had included a stock of Rs.175,092,481 which was in dispute. However, a provision of Rs.109,935,365 had been made for balances identified as non saleable.

1.2.2 **Accounts Receivables and Payable**

The following matters were observed.

- (a) The value of recoverable container deposit as at the end of the year under review amounted to Rs.7,226,842 out of which a sum of Rs.3,722,648 was related to the year under review and the balance of Rs.3,504,194 was related to the years 2003-2010

- (b) Out of the total value of trade debtors amounting to Rs.4,730,606,130, a sum of Rs.3,937,579,457 had been the debts receivable from the Director General of Health Services. It included a loan balance of Rs.2,348,736,498 remained outstanding for more than 01 year and the balance of Rs.301,065,701 was remained outstanding for more than 5 years.

1.2.3 **Non-compliances with Laws, Rules, Regulations and Management Decisions**

The following non-compliances with laws, rules and regulations were observed.

**Reference to Laws, Rules  
Regulations etc**

**Non - compliance**

- | <b>Reference to Laws, Rules<br/>Regulations etc</b>                                       | <b>Non - compliance</b>   |
|---|---|
| -----   | -----   |
| (a) Public Finance Circular No.PF/PE/6 dated 31 January 2000                              | Instead of recovering PAYE Tax from employees, the PAYE tax amounting to Rs.2,776,773 had been paid out of the Corporation's Fund.  |
| (b) Circular No.9 dated 01 March 2006 of the National Procurement Agency<br>Section 2.9.1 | The amounts payable to the Chairman of the major procurement committee and the other members are Rs.3,000 and Rs.2,000 respectively but they had been paid at Rs.17,500 and Rs.15,000 respectively. The amount payable to minor procurement committee Chairman and the other members are Rs.500 and Rs.250 respectively but they had been paid at Rs.12,500 and Rs.10,000 respectively. |
| Section 2.9.1   | Procurement committee meetings were held  |

during normal duty hours.

Section 2.2.9                      Eventhough the average of salaries of 12 officers had exceeded by Rs.289,913, the overpayments maid to officers remaining in the procurement committee in future is being recovered by installment basis.

Section 6.3.6                      The specific forms had not been used for opening bids and the committee members had not signed thereof.

(c) Valued Added tax              Instead of deductible Input Tax as at 31 (Amendment ) Act              December 2010, the total input tax had been No. 09 of 2011              deducted and paid. As such the payment of Valued Added Tax liability amounting to Rs. 28, 425, 110 for the 1<sup>st</sup> quarter of the year 2011 had been evaded.

(d) Procurement                      Before the appovel of the decision of the Guidelines 2.14.1              purchase of cellulose wadding Bp (1998) in 500g rolls valued at Rs.100,909,346 by the Cabinet of Ministers the corporation had ordered the material. The Chairman had informed that the responsible officer for this had been under interdiction and a disciplinary enquiry is being conducted.

1.2.4                      **Apparent Discrepancies and Irregular Transaction**

The expenditure of Rs.10,454,080 incurred on Ampicillin Injection BP 250 mg drugs rejected by the Medical Supplies Division due to inferior quality had not been recovered from the relevant supplier or to obtain new stock in place of inferior quality drugs.

## 2. **Financial Review**

### 2.1 **Financial Results**

According to the financial statements presented the operation of the Corporation for the year ended 31 December 2011 had resulted in a pre tax net profit of Rs.515,843,207 as Compared with the pre-tax net profit of Rs.483,774,625 for the proceeding year thus showing an increase of Rs.32,068,582 as compared with the preceding year.

Before deducting the finance cost of Rs.422,895,753 in the year under review , the corporation had earned an operating profit of Rs.938,738,960. When it is compared with the operating profit of Rs.816,578,399 before deducting the fiance cost in the preceding year, the increase in operating profit amounted to Rs 122,160,561.

The Gross Profit Ratio of the year under review and the preceding year had been 11.14% and 11.59% respectively. Similarly , the Net Profit Ratio for the year was 1.59% and it was 1.25% for the preceding year.

Increase in sales amounting to Rs.2,161,813,332 and the recovery of Rs.46,504,669 from supplies on account of rejected stock had been the reasons for the increase in net profit for the year under review.

### 2.2 **Analytical Financial Review**

- (a) (i) Significant data about the financial results of the year under review and the corresponding values for the preceding year is given below.

	<u>Year 2011</u>			<u>Year 2010</u>		
	<u>Corporation</u>	<u>D.H.S.</u>	<u>Total</u>	<u>Corporation</u>	<u>D..H.S.</u>	<u>Total</u>
	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million	Rs. million
Turnover /service charges	4,794	12,523	17,317	3,508	10,969	14,476
Cost of sales /direct expenses	3,756	11,706	15,462	3,202	10,280	13,483
Gross profit	1,038	817	1,855	989	688	1,677
Operating profit	525	413	939	466	351	817
Finances cost	1	422	423	7	325	333
Other income	27	46	73	24	-	24
Netprofit (pre tax)	524	(8.5)	516	458	25	484
Tax expenditure	235	-	235	231	13	244
Net profit (after tax)	273	(8.5)	265	170	9	180

(ii) **Financial Review of the Osusalas**

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
No. of Osusalas in operation	25	25	23	21	20
Profit earned (Rs.m)	95.31	96.62	97.38	44.21	54.81
No. of Osusales ran at losses	09	06	04	10	08
Loss incurred (Rs.m)	7.25	7.02	3.8	9.16	12.46

- (b) Number of Osusalas run at losses had increased from 06 to 09 in the year under review as compared with that of the preceding year, representing 36% of the total number of Osusalas.
- (c) The following 3 Osusalas had run at losses in the past 2 years and 3 years and the Osusala at Badulla bus stand had been closed in Number 2011.

	<b><u>Loss incurred</u></b>		
	2011	2010	2009
	Rs.	Rs.	Rs.
Bus stand – Badulla	2,187,893	1,419,707	1,893,568
Sathosa – Badulla	2,182,122	3,612,156	-
Hambantota	103,316	616,915	82,867

### 2.3 **Increase in Expenditure**

Five expenditure items had increased in the year under review as compared with the preceding year and major reasons for such increase are given below.

Item of Expenditure	2011	2010	Increase Percentage	Reason
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	Rs.	Rs.		
Value of leasing	1,469,067	468,749	213%	Commencement of new Osusalas and increase in annual leasing charges
Professional fees	1,289,879	501,713	157%	A monthly profession fee of Rs.100,000 paid to the Consultant in Accounting and Internal Control Systems

Director fees	348,750	54,000	546%	Increase in Directors remuneration and transport allowances
Donations	2,071,042	8,280	24,913%	Purchase of water bottles for Rs.1.5m for the distribution among food victims.
Drugs laboratory fees	735,568	136,447	439%	Testing were done through external drugs laboratories during the year 2011

## 2.4 Working Capital Management

(a) <u>Liquidity Ratios</u>		<u>2011</u>	<u>2010</u>	<u>Observation</u>
Current Ratio	- Actual	1.35	1.35	Sufficient working capital to settle liabilities was not available in the Corporation
	- Standard	2	2	
Quick Asset Ratio	- Actual	0.88	0.71	
	- Standard	1	1	
(b) <u>Activity Ratios</u>				
Debtors turnover ratio - times		3	4	Debt collection was not at a satisfactory level
Debtors turnover period - days		113	84	Collection period increased by 29 days

Stock turnover ratio times	5	3	No effective sales as compared with the stock of the Corporation.
Stock turnover period days	72	100	It took 72 days to turn the stock in to sales

### 3. Operating Review

#### 3.1 Management Inefficiencies

The following observations are made.

- (a) Drugs valued at Rs.153,725,956 supplies to Medical Supplies Division by the Corporation had been rejected out of which drugs valued at Rs.67,906,599 due to quality failures and drugs valued at Rs.72,179,561 due to misspecifications. Action had been taken to re-supply the quality failed stock valued at Rs.9,509,996 and drugs with misspecifications valued at Rs.11,699,811 from the above stocks to the Medical Supplies Division by the date of audit.
  
- (a) The tender for obtaining the service of clearance, transport and storing of drugs had been awarded to the contractor who had submitted a tender for the value of Rs.656,507, more than the previous year's tendered value and a sum of Rs.3,295,481 had been paid as stores rent for holding rejected / obsolete stock for 3 months period of the year under review.
  
- (b) Eventhough lodging of an insurance claim had been shown in the financial statements for stock of Rs.12,869,527 relating to the period 2001-2007 and for damaged/obsolete stock ofRs.19,466,338, Rs.23,241,960 and



Rs.16,325,200 relating to the years 2009, 2010 and the year under review, further action had not been taken in this regard.

### 3.2 Operating Inefficiencies

The following matters were observed.

- (a) Interest on bank overdraft paid during the year under review amounted to Rs.419.24 million and it had increased by 14% than that of the previous year.
- (b) 7,019,807 units of 257 items of obsolete drugs as at 31 December 2010 of which the value was not made available for audit and 19,801 units of 33 obsolete items of drugs during the period January to November 2011 had been stored in the building taken on rent at Ratmalana.
- (c) Instead of supplying surgical consumables of Bone Cement Low Viscosity requested by the Medical Supplies Division, the Corporation had supplied the surgical consumables of Bone Cement Medium Viscosity valued at Rs.1,900,976. As such the Medical Supplies Division had rejected to take over them on the ground that they were not in conformity with the requested specification.
- (d) At the test examination carried out by the National Drugs Quality Assurance Laboratory based on complaints made by Hospitals on Ampicilling Injection BP 250 mg drugs valued at Rs.10,454,080 supplied to the Medical Supplies Division it was established that the quality of their drugs was failed.
- (e) The value of demurrage charges which had been paid by the Corporation but not recovered from suppliers due to non - supply of Sodium Chloride Intravenous drug on time and due to payment of

container demurrage charges as a results of storing in the container of the external parties and non receipt of documents at the specified time amounted to Rs.1,461,064 and Rs.3,758,675 respectively.

- (f) As the Corporation had not taken action to establish whether the stock of Closed Wound Suction Drainage System and Thoracic Chest Drainage Catheter drug had been in conformity with specifications and condition in the import of this drug, it had been rejected by the Medical Supplies Division, as a results the loss incurred by the Corporation amounted to Rs.3,332,738.
- (g) Eventhough it was revealed that a casual substance had contained in the bottles of Sodium Chloride Intravenous drug bearing part No.306212147 which had been supplied to the Medical Supplies Division valued at Rs.229,233,142, this drugs had been completely used at that time. The effect of the patients there from had not been verified.
- (h) A sum of Rs. 119,003,021 had been paid as demurrage charges during the period from 2007 to 2011 due to non clearances of drugs within the specific period from the Port, imported for the Director General of Health services and the marketing purposes of the Cooperation. The Chairman informed that the demurrage charges had been maintained at a stated minimum level.

### 3.3 **Identified Losses**

The following losses were observed in audit.

- (a) Drugs valued at Rs.11,265,891 had been destroyed due to obsolescence, quality failures and breakage.

- (b) Due to rejection of acceptance of drugs by the Medical Supplies Division, an additional transport charges of Rs.1,267,656 and the demurrage charges of Rs.743,650 had to be paid.
- (c) Action had not been taken to recover the amount paid for surgical consumables or get back the relevant drugs valued at Rs.2,212,573 which had not been accepted by the Medical Supplies Division due to non conformity with the specification relating to the order No.DHS/SU/003/01 G/09.
- (d) Due to incorrect adjustment of Notional Tax in the years 2007 to 2010 in terms of Section 138 of the Inland Revenue Act. N.10 of 2006 a financial loss of Rs.447,864 was incurred.
- (e) Due to storing 323,500 bottles of drugs relating to order No.DHS/JA/304/10 & 484/10 in a private store which had not been taken over by the Medical Supplies Division on the ground of unavailability of store facilities, 37,325 bottles valued at Rs.1,597,480 had been completely destroyed by rain.
- (f) A sales income of Rs.3,863,610 had been defrauded at Negambo Osusala by preparing fraudulent documents as banked.

#### 4. Accountability and Good Governance

##### 4.1 Corporate Plan

Out of the objectives expected to be archived as stated in the Corporate Plan for the period 2007 to 2011 the Corporation had failed to achieve

the establishment of the information and management system, providing laboratory facilities to Colombo 7, new building, construction of the new drugs store at Ratmalana during the year under review.

#### 4.2 Action plan

The following activities stated in the Action Plan could not be archived during the specific periods.

Activity	Expected period of completion as per Action plan
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i. Identification of places in which State Osusalas to be opened in Puttalama, Gampaha, Bactticloa Districts.	At the end of the 1 <sup>st</sup> quarter of 2011
ii. Recruitment of one Analyst for quality laboratory and 2 Quality Control Assistants.	June 2011
iii. Transferring a part of quality laboratory activities to the Dangerous Drugs Control Authority.	August 2011

#### 4.3 Internal Audit

The Internal Audit Division had paid more attention to audit the Osusalas without being examined in the internal control systems of sales system, procurements, and stock control divisions during the year under review.

#### 4.4 Procurement Plan

A Procurement Plan had not been prepared for the year under review and it had been established for the year 2012.

#### 4.5 Budgetary Control

Significant variations between the budgeted expenditure and the actuals were observed and as such the budget had not been made use of as an effective instrument of management control.

5. **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 the following areas of control.

- (a) Sales
- (b) Stocks
- (c) Procurement procedure
- (d) Debtors control and collection
- (e) Up- dating records
- (f) Information technology and communication
- (g) Banking of collection in Osusalas