State Pharmaceuticals Corporation of Sri Lanka - 2013

The audit of financial statements of the State Pharmaceuticals 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 financial performance 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.

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report the financial statements give a true and fair view of the financial position of the State Pharmaceuticals Corporation of Sri Lanka as at 31 December 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 Sri Lanka Accounting Standards

The employees retirements benefits liability had not been valued by an Actuarial Valuer in terms of Sri Lanka Accounting Standard No. 26.

2.2.2 Accounting Deficiencies

The following observations are made.

(a) The interest income of Rs.70,687 for the year under review on Treasury Bills had not been brought to account and as such, the interest income for the year under review and the value of investments for the year had been understated by that amount.

(b) Out of the drugs and surgical consumables supplied to the Medical Supplies Division, a quantity valued at Rs.201,499,316 had been returned as unusable. Even though policy of the Corporation is to make full provision for unusable stocks, provision had been made only for stocks valued at Rs.194,776,269. As such the provision for the year under review had been understated by a sum of Rs.6,723,047.

(c) Twenty eight Debit Notes relating to drugs and surgical consumables valued at Rs.39,564,102 supplied to the Medical Supplies Division had not been brought to account in the financial statements for the year under review. As such the debtors and sales had been understated by that amount.

2.2.3 Accounts Receivable and Payable

The following observations are made.

(a) According to the financial statements presented, the total Trade Debtors balance of the Corporation as at 31 December 2013 amounted to Rs.9,375,792,807 and out of that 97.1 per cent or Rs.9,106,376,617 had been debts receivable from the State and the Semi – State Institutions. Out of that a sum of Rs.8,745,480,896 or 93.2 per cent had been due from the Medical Supplies Division.

(b) Out of the sum of Rs.8,745,480,896 receivable from the Medical Supplies Division, the debtors balance older than one year amounted to Rs.2,557,369,588. That, included a debtors balance of Rs.746,848,430 older than 05 years.

(c) Out of the sum of Rs.630,311,911 receivable from the private, State and Semi-State institutions except the Medical Supplies Division, the debtors balance older than one year amounted to Rs.23,458,276 and the debtors balance older than 05 years amounted to Rs.2,296,204.

(d) Out of the debts amounting to Rs.11,837,291 remaining outstanding for more than 02 years from 18 customers in the private and the State Sectors and included in the debtors balance as at 31 December 2013, the Corporation had failed to make any recoveries whatsoever by the end of the year under review.

(e) Out of the sum of Rs.763,487,280 relating to the period from the year 2003 to 31 December 2013, the payment of which had been rejected by the Medical Supplies Division, only a sum of Rs.46,160,533 out of the sum of Rs.138,502,967 relating to the year 2013 had been recovered from the supplier.

(f) Without taking action for the recovery of advances amounting to Rs.1,388,839 paid for the import of drugs on 09 Indents during the years 2007 to 2011, those had been brought forward as advances paid to suppliers.

(g) Even though the customers of the Corporation had been allowed credit facilities up to the value of the Bank Guarantee produced, according to a decision of the Board Directors, additional credit facilities exceeding the value of Bank Guarantees by 50 per cent had been allowed again in two instances to selected customers. Such credit allowed amounted to Rs.10,440,050 given to 3 Distributors, Rs.661,572 given to 05 Agency Osusala, and Rs.306,008,863 given 74 customers of State Osusala outlets. Such credit given in the year under review as compared with preceding year had increased by Rs.299,854,398 or 1738 per cent.

(h) Out of the value of Bank Bills payable the suppliers in the purchase of drugs, the sum retained without being paid amounted to Rs.2,919,970,104 as at the end of the year under review. That balance included Rs.10,953,252 older than 05 years, Rs.289,228,814 old between 01 year to 04 years and Rs.2,619,788,038 less than one year old.

2.2.4 <u>Lack of Evidence for Audit</u>

The following observations are made.

(a) The evidence relating to the confirmation of the debtors balances totaling Rs.74,247,428 of 343 trade debtors and Rs.866,363,958 of the Medical Supplies Division had not been furnished to audit.

(b) The evidence relating to the confirmation of creditors balance totaling Rs.85,595,103 of 86 trade creditors had not been furnished to audit.

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

Instances of non-compliance with laws, rules, regulations and management decisions are given below.

Reference to Laws, Rules, Regulations and Management Decisions	Non-compliance
(a) Financial Regulation 756 of the Democratic Socialist Republic of Sri Lanka	The fixed assets of the Head Office had not been subjected to physical stock survey during the year under review.
(b) Establishments Code of the Democratic Socialist Republic of Sri Lanka Chapter VIII Section 10.1 and Public Enterprises Circular No. 95 of 04 June 1994	The approval of the General Treasury had not been obtained for the payment of allowances at a minimum of Rs.1,000 and Maximum of Rs.2,800 for officers in Junior Executive and the Executive Grades for working for more than 07 hours on holidays.
(c) Public Finance Circular No. PF/PE/6 of 31 January 200	Contrary to the circular instructions the Pay As You Earn Tax in respect of the preceding year and up to March of the year under review had been paid from the funds of the Corporation. The payments made up to March of the year under review amounted to Rs.656,188 and action had not been taken for the recovery of that amount from the employees.
(d) Public Enterprises Circular No. PED/12 of 02 June 2003	Contrary to the circular, the draft Annual Report for the year under review had not been presented to the Auditor General even by the date of this report.
(e) Public Enterprises Circular No. PED/57 of 11 February 2011	Donations and sponsorship exceeding Rs.100,000 in value totaling Rs.10,323,937 had been made in 16 instances to non-Governmental institutions without the approval of the Minister of Finance.

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 profile of Rs.777,218,094 as compared with the corresponding pre-tax net profit of Rs.497,060,601 for the preceding year thus indicating an increase of Rs.280,157,493. Nevertheless, the Corporation had earned an operating profit of Rs.778,828,736 in the year under review, before deducting the financial expenditure. That as compared with the operating profit of Rs.787,954,653 for the preceding year before deducting the financial expenditure indicated decrease of the operating profit by a sum of Rs.9,125,917. The decrease of the operating profit in the year under review had been due to an increase of the provision for bad debts, the Value Added Tax, the Nation Building Tax and the stock losses by Rs.143,825,630 , Rs.32,967,916 , Rs.15,599,262 and Rs.40,528,226 respectively.

3.2 Analytical Financial Review

A comparison of the stock turnover ratios for the years 2013 and 2012 revealed an increase of 0.9 and decrease of stock turnover period by 05 days. The debtors turnover ratio had decreased by 0.5 and the debt collection period had increased by 34 days. Comparison of the creditors turnover revealed on increase by 1.4 and creditors settlement period had decreased by one day.

3.3 Legal Action instituted against or by the Corporation

Four external institutions / individuals had filed 04 cases in the Courts against the Corporation in connection with the breach of fundamental right relating to award of bids, demotion from post and blacklisting. The compensation claimed in that connection amounted to U.S.$ 948,759. The Corporation had filed 02 cases in the Courts against 02 external institutions claiming compensation amounting to Rs.4,633,435 for defrauding public funds.

4. Operating Review

4.1 Operating Inefficiencies

The following observations are made.

(a) The stock of 340 million tablets supplied in June 2010 out of the order made for 650 million units of Paracetamol Tablet BP 500mg under Bill No. DHS/CCJ/P/361/2008/09 had been discoloured and as such the total quantity ordered had been cancelled. A Debit Note amounting to Rs.30,885,377 equivalent to U.S.$ 232,152 had been issued to the supplier on 10 July 2010 on 102.14 million tablets withdrawn from use out of the supply made. The supplier had made a claim of U.S.$ 944,261 to the Corporation on 19 October 2010 being the cost of 310 million of units manufactured but not taken over. Even though the supplier had made a complaint to the Arbitration Tribunal on 21 April 2011 for the cancellation of the balance supply of 310 million tablets withdrawal of the drug from use and the loss of valid registration. That had not been settled even by 31 December 2013. The Corporation had spent a sum of Rs.967,307 on the Arbitration up to that date.

(b) Purchase of 750,000 Units of Amoxicillin Oral Suspension (BP) 125mg/small valued at Rs.14,529,000 under Indent. No. DHS/P2/267/2004

The bid for the supply of 750,000 units of the above drug for Rs.14,529,000 had been awarded to an Indian supplier who had submitted the lowest quotation without producing samples. The supplier had been informed on 18 April 2008 that the drug was withdrawn from use after the expiry of the shelf life of the drug and the Debit Note No. 095 claiming Rs.6,097,058 for 290,464 quality failed units had been sent him sent on 21 June 2008. The Supplier had not agreed to pay that amount and the irrecoverable sum of Rs.6,097,058 had been written off from the books in terms of the Board Decision No. BP/253/13 taken at the meeting No. 686 of the Board of Directors held on 22 November 2013.

Even though the Corporation had the power under clause 10 of the Bid Documents to stop the supply of balance stocks when failure of quality tests are reported such action had not taken on 250,000 units shipped in March and April 2005.

(c) The Corporation had been obtaining Bank overdrafts annually and the overdraft interest paid in the year under review amounted to Rs.511,697,230 as compared with the overdraft interest of Rs.654,794,055 paid in the preceding year. In addition the General Treasury had reimbursed a sum of Rs.816,942,256 from the year 2012 and as such the interest on overdrafts for the year under review had been understated.

(d) A sum of Rs.9,552,240 had been paid in the year under review for 04 buildings taken on rent from Kelaniya and Ratmalana for storing validity expired drugs and the drugs in the validity period. It was observed in audit that the validity expired drugs had been held in the stores over long periods without taking action for their disposal.

(e) Action had not been taken even by 25 August 2014 for the recovery of the recoverable container deposit amounting to Rs.2,807,500 deposited from the year 2007 to the year 2010 for the containers obtained from private container companies for the transport of drugs from the port to the Corporation and the Ministry of Health.

(f) Out of 672 items of drugs ordered for the Medical Supplies Division during the year under review, the Corporation had failed to supply 1,507.1 million units of 360 items of drugs and the quantity not supplied in respect of 141 items for which no supplies whatsoever had been made amounted to 342.3 million units.

(g) Activities of Osusala Outlets
The particulars of the activities of Osusala Outlets during the year under review and the 04 preceding years had been as follows.

	2013	2012	2011	2010	2009
	Rs.	Rs.	Rs.	Rs.	Rs.
Number of Osusala Outlets in operation	31	28	25	25	23
Turnover Rs.Millions	2,360.2	2,185.9	1,974.8	1,840.2	1,691.4
Purchases – Local Rs.Millions	1,246.9	1,189.8	963.3	918.7	791.7
Purchases – Imported Rs.Millions	729.3	718.4	678.8	683.7	677.7
Profit Earned – Rs.Millions	90.3	134.1	102.6	96.6	97.4
Number of Loss Making Osusala Outlets	15	10	09	06	04
Loss incurred – Rs.Millions	20.7	8.1	7.2	7.0	3.8

The following observations are made.

(i) The Corporation had 31 Osusala Outlets during the year under review and three Osusala Outlets had been newly opened. The Corporation had earned a profit of Rs.110,952,631 from the working of 16 Osusala outlets during the year under review.

(ii) Fifteen Osusala Outlets including the 03 newly opened outlets had incurred a loss of Rs.20,664,011 during the year under review. That as compared with the loss of Rs.8,073,076 for the preceding year indicated an increase of Rs.12,590,935 in the loss. The net profit for the year under review had decreased to Rs.90,288,620 due to the losses incurred by those Osusala Outlets.

(iii) The Osusala Outlets at Avissawella, Ampara, Hambanthota and Meegoda had incurred losses amounting to Rs.6,202,467 in the year under review and the losses incurred by those in the years 2011 and 2012 amounted to Rs.1,249,415 and Rs.1,311,360 respectively.

(iv) In addition to the Osusala Outlets referred to in (iii) above, the 05 Osusala Outlets at Karapitiya, Jaffna, Polonnaruwa, Piliyandala and Kalutara had incurred losses in the year 2012 and the year under review and those losses totaled Rs.6,004,788 and Rs.5,770,330 respectively. Out of those, the Osusala Outlet in Jaffna had incurred heavy losses amounting to Rs.4,142,214 and Rs.4,356,674 respectively.

According to the matters referred to in (iii) and (iv) above those Osusala Outlets indicate continuous loss making status and the loss of Rs.11,972,797 incurred by the 09 Osusala Outlets in the year under review represented 58 per cent of the overall loss incurred by the 15 Osusala Outlets.

4.2 Deficiencies in Contract Administration

Construction of a Three Storeyed Building for Nugegoda Osusala

A land 5.9 perches in extent belonging to the Dehiwala Mount Lavinia Municipal Council had been taken on lease basis for a period of 30 years from 01 December 2010 to 30 November 2040 for a sum of Rs.8,804,000 and a three storeyed building had been constructed on the land. The contracts for Rs.12,658,559 excluding the Value Added Tax had been awarded on 18 November 2011 to the contractor who submitted the lowest quotation with the stipulation that the work should be completed and handed over in 06 months. The value had increased to Rs.16,073,677 excluding the Value Added Tax due to additional work of the contract, errors in the bills of quantities and the price fluctuations. A further sum of Rs.72,800 had been paid to the Institute of Constructions Training and Development to determines whether an amount exceeding the agreed contract price could be paid due to the errors in the bills of quantities.

The three storeyed building of 2210 square feet had been constructed on a land not legally belonging to the Corporation.

4.3 Management Inefficiencies

The following observations are made.

(a) The favourable balances as at 31 December 2013 amounting to Rs.17,047,540 in a current account opened in a State Bank for the import of specially ordered drugs remained idle for two years up to the end of the year under review.

(b) The drugs costing Rs.39,564,102 included in the stocks in transit of the Medical Supplier Division amounting to Rs.686,191,229 included in the financial statements for the year 2012, due to the inability to identify whether those had been handed over to the Medical Suppliers Division and the stock shortage amounting to Rs.1,020,462 revealed in the physical verification of stocks, both totaling Rs.40,584,564 , had been written off as losses without the approval of the Board of Directors and the Treasury.

(c) The value of insurance indemnity for damaged drugs from the year 2003 to the year under review amounted to Rs.11,726,967. Out of that the amount recoverable by the Corporation in respect of the years 2003 to 2010 amounted to Rs.4,063,277. Adequate attention had not been paid over a long period for the recovery of the money.

(d) The delay in taking legal action for the recovery of a sum of Rs.2,368,958 from a Customer of the Corporation who had not made any transactions for more than two years had been seven months. Even though a letter of demand was issued in the year 2012 for the recovery of another sum of Rs.7,301,267 receivable from another customer, legal action could not be taken as the location of the institution could not be traced. Accordingly, adequate courses of action had not been taken for the recovery of money despite the elapse of about one year.

4.4 Identified Losses

The following observations are made.

(a) Unsaleable Drugs

According to the financial statements, out of the drugs imported by the Corporation from the year 1996 to the year 2012, drugs valued at Rs.123,312,460 and drugs valued at Rs.42,110,540 out of the drugs imported in the year under review had become unsaleable. As such the Corporation had incurred a loss of Rs.165,423,000. The value of the above stock according to the stock verification report produced to the Audit Committee meeting amounted to Rs.125,933,495 (together with the stocks of Osusala Outlets). According to the information produced to audit subsequently, information on Rs.16,011,626 of the difference was revealed, leaving a further difference of Rs.23,477,879 in the stocks.

As such the possibility of unsuitable stocks reaching the marked due to the physical non-existence of damaged drugs cannot be ruled out in audit.

(b) The Corporation had incurred a loss of Rs.201,499,316 being the value of drugs and surgical consumables included in the stocks in transit rejected by the Medical Supplies Division.

(c) The Corporation had incurred a stock loss of Rs.18,681,006 being the value of sales of the years from 2006 to 2011 not brought to account up to date and the value of 10 Debit Notes rejected by the Medical Supplies Division.

(d) A stock of 473,500 units of two items of drugs valued at Rs.3,080,334 not taken over by the Medical Supplies Division due to lack of storage facilities and left in the containers in the Ceylon Shipping Lines Yard had been destroyed due to heavy rains. That stock of drugs had been destroyed in accordance with the decision of the Board of Directors taken at the meeting No. 668 dated 01 June 2012.

The following matters were revealed in this connection.

(i) Even though a Debit Note for Rs.972,418 for the destruction of 53,500 units of Intravenous Cannula Sets valued at Rs.972,418 imported under Indent No. DMS/SWW/02/70E/08-09 had been sent to the Medical Supplies Division, that amount had not been paid by the Medical Supplies Division.

(ii) The value of the Debit Note No. 000120/2013 for Rs.1,308,804 issued on 01 April 2013 to the foreign supplier of Intravenous Cannula Sets of which 76,000 sets had been withdrawn from use and as notified the supplier by the Corporation on 24 July 2013, had not been paid to the Corporation by the Supplier even by January 2014.

(e) As the supplier did not agree with the decision of the Technical Evaluation Committee made at the meeting held in the Ministry of Health on the withdrawal from use 14,000 bottles of Lindane Lotion BP/USP2 per cent imported under Indent No.DHS/P8/298/2012 the Corporation had incurred a loss due to the inability to recover the amount from supplier.

4.5 Staff Administration

The following observation are made.

(a) The approved staff as at 31 December 2013 had been 957 and the actual staff as at that date had been 821. Accordingly the vacancies amounted to 136 comprising vacancies in 13 Executive Grades. 99 Non-executive Grades and 24 Minor Grades.

(b) Four officers of the Corporation had been appointed on acting basis for periods ranging from 01 year to 08 years contrary to the Circular No. 124 dated 24 October 1997 of the Ministry of Finance and Planning.

5. Accountability and Good Governance

5.1 Action Plan

Five activities due for implementation in the year under review by the Corporation included in the Action Plan had not been implemented.

5.2 Budgetary Control

Variances ranging from 17 per cent to 715 per cent were observed between the budget for the year under review and the actual income and expenditure thus indicating that the budget had not been made use of as an effective instrument of management control.

5.3 Tabling of Annual Reports

The Annual Report for the year 2012 had not been tabled in Parliament.

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 weaknesses in the areas of control.

(a) Stock Control
(b) Osusala Outlets Control
(c) Debtors and Creditors Control
(d) Creditors
(e) Human Resources Management
(f) Budgetary Control