State Pharmaceuticals Manufacturing Corporation of Sri Lanka - 2017

The audit of financial statements of the State Pharmaceuticals Manufacturing Corporation of Sri Lanka for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 (1) of the Finance Act, No. 38 of 1971 and Section 29 of the State Industrial Corporations Act, No.49 of 1957. My comments and observations which I consider should be published with the Annual Report of the Corporation in terms of Section 14 (2) (c) of the Finance Act appear in this report.A detailed Report in terms of Section 13(7)(a) of the Finance Act was furnished to the Chairman of the Corporation on 26 July 2018.

1.2 Management's Responsibility for the Financial Statements

The 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 Auditing Standards of Supreme Audit Institutions (ISSAI 1000-1810). Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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 Manufacturing Corporation of Sri Lanka as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Accounting Standards

The following observations are made.

(a) Sri Lanka Accounting Standard 1

Even though assets and liabilities should not be offset against each other in terms of Section 32 of the Standard, debit balance of Rs.166,155 in the Pay As You Earn Tax Account of the Corporation had been offset against the credit balance of Rs.112,457,527 of the Trade and Other Creditors Account and it had been shown as Rs.112,291,372 in the financial statements.

(b) Sri Lanka Accounting Standard 16

Since useful life of non-current assets had not been reviewed annually in terms of Paragraph 51 of the Standard, fixed assets costing Rs.223,206,845 had still been in use despite being fully depreciated.Accordingly, action had not been taken to revise the error in the estimation in terms of Sri Lanka Accounting Standard 08.

(c) Sri Lanka Accounting Standard 24

According to Paragraph 17 of the Standard, information relating to Key Management Personnel Compensation had not been disclosed in the financial statements.

2.2.2 Accounting Policies

The following observations are made.

(a) In terms of Paragraph 4.56 of the Conceptual Framework for Financial Reporting, although the historical cost method is the method of measurement abundantly used in the preparation of financial statements by the Corporation, it remains combining with other methods of measurements. As such, separate methods of measurements should be identified for measuring assets and liabilities. Nevertheless, without carrying out such identification by the Corporation, it had been stated that only the historical cost method would be used under Accounting Policy 2.2. in the financial statements.

(b) According to Paragraph 67 of Sri Lanka Accounting Standard 19, the projected unit credit method should be used in the computation of employees gratuity liability. Nevertheless, it had not been disclosed in the accounting policies as to whether the above method was used by the Corporation.

2.2.3 Accounting Deficiencies

Although it had been stated by the Letter No.MSD/SB11/SPMC/2017/QF dated 02 October 2017 of the Director of the Medical Supply Division that a stock of Folic Acid Tablets sold to the Medical Supply Division during the year 2014 had failed in quality, a sum of Rs.1,609,965 payable thereon to the above division had not been brought to accounts.

2.3 Accounts Receivable and Payable

Action had not been taken either to refund or credit to the revenue a sum of Rs.429,955 retained in making payments for 03 suppliers for over a period of 2 years.

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

The following instances of non-compliance with laws, rules, regulations and management decisions were observed.

Reference to Laws, Rules and Regulations	Non-compliance
(a) Public Finance Circular No.438 of 13 November 2009	Action had not been taken to dispose of the stocks of raw materials, finished goods and packaging materials costing Rs.17,360,465 that remained unusable as at 31 December 2017 as well as 395 units of assets costing Rs.56,788,918, the book value of which was zero.

(b) Paragraph No.02-01 of the Letter No.DMS/E4/10/4/090/2 dated 09 March 2009 of the Department of Management Services addressed to the Secretary to the Health.	(i) Contrary to the relevant letter, a transport allowance of Rs.4,700 and Rs.3,000 had been paid monthly to the executive and non-executive officers of the Corporation respectively from the year 2009 regardless of the distance travelled. According to a decision of the Board of Directors, that allowance had been paid by increasing the same up to Rs.5,450 and Rs.3,750 respectively from the year 2016.
	(ii) In terms of the letter, although a sum of Rs.4,000 only could be paid to the staff members as a monthly production incentive, without being complied with that, production incentive had been paid to the entire staff subject to a maximum of Rs.12,000 per month with effect from 01 July 2011. Accordingly, overpayments totalling Rs.62,719,822 had been made from July 2011 up to 31 December 2017 comprising the overpayment of Rs.17,154,670 made during the year under review.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the financial result of the Corporation for the year under review had been a net profit of Rs.223,907,939 as compared with the corresponding net profit of Rs.296,646,714 for the preceding year, thus indicating a deterioration in the net profit by Rs.72,738,775 in the year under review as compared with the preceding year. Even though the expenditure on tax had decreased by Rs.46,443,591 in the year under review as compared with the preceding year, decrease of the gross profit by Rs.38,323,331 and increase in administrative expenditure and sales and distribution expenditure by Rs. 38,790,533 and Rs.19,250,140 had mainly attributed to the above deterioration in the financial result.

An analysis of financial results of the year under review and 04 preceding years revealed a continuous net profit from the year 2013 up to the year under review. Nevertheless, it had fluctuated annually. After readjusting the employees' remuneration, Government tax and depreciation for the non-current assets to the financial results, the contribution of the Corporation amounting to Rs,662,577,528 in the year 2013 had improved up to Rs.838,962,510 in the year 2017 with fluctuations between 6 per cent and 10 per cent and contribution of the year 2017 had decreased by 4 per cent in relation to the year 2016.

3.2 Analytical Financial Review

The following observations are made.

(a) As compared with the preceding year, the Gross Profit Ratio and the Net Profit Ratio had decreased by 6.4 per cent and 8 per cent respectively during the year under review.

(b) As compared with the preceding year, the Debtors Turnover Ratio had decreased by 14.1 folds and the loan recovery period had extended by 15 days. The Creditors Turnover Ratio had increased by 6.8 folds and the creditors turnover period had been reduced by 5 days. It was observed that the efficiency of the operating activities of the Corporation should be increased by paying attention on the above matter.

4. Operating Review

4.1 Performance

4.1.1 Operation and Review

Out of the activities included in the Action Plan prepared for the year under review, it had been failed to carry out 05 activities relevant to the Marketing Department, one activity relevant to the Manufacturing Department, 06 activities relevant to the Quality Control Department, 02 activities relevant to the Human Resources Department, 03 activities relevant to the Formula and Development Department, 02 activities relevant to the Engineering Department and one activity relevant to the Information Technology Department

4.2 Management Activities

The following observations are made.

(a) Even though the purchase of drugs manufactured by private institutions and reselling of such drugs is not an objective coming under the main objectives of the Corporation, without being properly amended the objectives specified in the Act and obtained the approval of the Cabinet of Ministers, an agreement had been entered into with an Indian Company on 05 April 2016 for the production and supply of drugs to the Corporation. Since the period of the above agreement had ended on 04 April 2017, a new agreement had been entered into for a period of one year on 14 December 2017.

(b) In calling for bids for the purchase of 1,000 units of raw materials of the Theophylline Anhydrous USP 32 drug, the order had been awarded on 24 May 2017 to the bidder who had presented the minimum quotations and payment had been made under Telegrapic Transfer method on 25 May 2017. Nevertheless, the 1,000 units of raw materials had not been received by the Corporation even by 30 June 2018. The following observations are made in this connection.

(i) In terms of conditions included in the agreement and the bid documents relevant to the procurement, payments should be made to the supplier through the Letters of Credits. Nevertheless, contrary to that, payments had been made before the receipt of raw materials through the Telegrapic Transfer method without being obtained the approval of the Procurement Committee and contrary to the provisions indicated in the Financial Regulation 237 (b).

(ii) Since 3,000 kilograms of this raw material had been ordered on 27 October 2016 from another supplier before the award of this order and that stock was due to be received by the Corporation by June 2017, there was no room for arising a stock shortage. Nevertheless, the reason behind the placing order for 1000 kilograms of this raw material again and making urgent payment through the Telegrapic Transfer method was not revealed to Audit.

(iii) Due to an order made under the sign of the Deputy General Manager (Finance) and the Deputy General Manager (Quality Control) without establishing the authenticity of a false e-mail message received by the Manager (Planning and Procurement) on 25 May 2017 to the effect that the bank account number had been changed due to a tax computation and money be deposited to that new number, a sum of Rs.1,577,780 had been paid on 25 May 2017 so as to be credited to a bank account referred to in the false e-mail message which was not owned by the proper supplier.

(iv) According to the authority vested in the Deputy General Manager (Quality Control) who was the second signee, his maximum approvable limit amounted to Rs.500,000, whereas approval had been granted for making payment exceeding the above limit.

(v) Although Rs.331,000 out of the total loss of Rs. 1,577,780 had been recovered from the performance bid security of the supplier, the balance of Rs.1,246,780 had not been recovered even by 20 July 2018.

(vi) Action had not been taken to identify the officers responsible for the loss incurred and recover the same.

(c) Even though a shortage of 08 items costing Rs. 391,250 included in the Register of Fixed Assets had been revealed at the physical stores verification held on 31 December 2017, action had not been taken to identify the reasons attributed to the shortage and make remedial measures and to take future steps in terms of Financial Regulation 103.

(d) Since drugs had been imported from an Indian Company, manufacturing of 04 items of drugs had been discontinued during the year under review and as such, 204 kilograms of raw materials costing Rs.1,789,731 imported for the production of the above 04 items of drugs remained unused over a period of one year.

43 Operating Activities

The following observations are made.

(a) The Medical Supply Division had placed orders for Domperidone Malate BP drugs at 50 million units during the years 2017 and 2018. Although 100 kilograms of raw materials costing Rs.1,214,384 had been purchased for the production of the above medicine in October 2017, that medicine had not been manufactured during a period of 8 months up to 04 June 2018. Plans had not been drawn for the production of that medicine even in the production plan given to the Audit pertaining to the month of March 2018. However, instead of manufacturing that medicine, the total order had been completed from the drugs imported from Till Healthcare (Pvt) Ltd in India.

(b) The remaining stock of the raw material called Microcrystalline Cellulose-200XML stood at 406 kilograms by August 2017 and the above stock had expired as at that date. The drug which is manufactured using the above raw material had not been manufactured after August 2017 and raw materials costing Rs.7,943,351 had been purchased at 3,000 kilograms, 2,000 kilograms and 3,000 kilograms in January, February and June 2018 respectively. However, those raw materials had not been utilized for manufacturing activities even by 18 June 2018.

(c) Out of the drugs ordered by the Medical Supply Division for the year under review, the Corporation had failed to supply 39,174 million units of 08 categories of drugs, the sales price of which was Rs.70,113,783 during the year under review.

4.4 Transactions of Contentious Nature

Although dinner had been provided at a cost of Rs. 595,000 for the medical officer for two days during the year under review, particulars on the medical officers to whom the dinner had been provided and the requirement for providing the dinner were not furnished to Audit.

4.5 Identified Losses

Five items of raw materials valued at Rs.2,438,354 had expired by 31 December 2017, whereas action had not been taken to recognize the parties responsible for the loss by conducting a formal inquiry and properly dispose of such raw materials and eliminate them from the stock registers.

4.6 Staff Administration

The following observations are made.

(a) Action had not been taken to fill the post of Deputy General Manager (Sales) that remained vacant from a period of 07 years by 05 June 2018, the date of audit.

(b) Five officers had been recruited to 05 posts on contract basis, exceeding the approved cadre.

(c) Five officers had been recruited on contract basis as one officer in 2016 and 04 officers in 2017 for the posts of Formula and Research Executive, Media Coordinating Officer, Programme Coordinating Officer and the Project Coordinator which had not been included in the approved cadre. Since there was no approved scheme of recruitment for those posts, it could not be examined as to whether the officers with sufficient qualifications had been recruited for the above posts.

(d) It had been reported that having published a newspaper advertisement on 02 July 2017 in order to fill the vacancies of the post of Deputy General Manager (Human Resources), the interview was conducted for three applicants selected out of the received applications, whereas the report of the interview board had not been signed by the members of the above board. An applicant whose age had exceeded the age limit included in the scheme of recruitment had been recruited on contract basis for a period of 06 months with effect from 20 September 2017 on the instructions of the Chairman and the approval of the Board of Directors of the Corporation and without taking action to permanently fill the above post since a period of 08 months even by 05 June 2018, service of the aforesaid officer had been extended. The reasons behind the making recruitment to this permanent post on contract basis were not furnished to audit.

(e) In terms of scheme of recruitment pertaining to the recruitment of minor employees of the Corporation, employees should be recruited by publishing vacancies through newspaper advertisements, conducting interviews and giving marks according to the qualifications. Nevertheless, contrary to that, 20 minor employees comprising 19 on permanent basis and one employee on contract basis had been recruited relating to the posts of Driver, Drugs Manufacturing Assistant and Labourer during the year under review. Further, a labourer and a driver recruited on contract basis in the preceding years had been confirmed in those posts during the year under review without following the scheme of recruitment.

(f) Without publishing vacancies through the newspaper advertisements, conducting written test and an interview and without giving marks for the qualifications in accordance with the scheme of recruitment relevant to the non-executive employees of the Corporation, 09 officers had been recruited on permanent basis to the post of Management Assistant and Drugs Technician during the year under review.

5. Sustainable Development

5.1 Achievement of the Sustainable Development Goals

Every Public institution should take steps in accordance with the Agenda 2030 of the United Nations Sustainable Development Goals. Although the State Pharmaceutical Manufacturing Corporation was aware of the manner in which it should take action in connection with the functions coming under its scope, the parties interested in the functions of the State Pharmaceutical Manufacturing Corporation with regard to the implementation of sustainable development goals had not been recognized.

6. Accountability and Good Governance

6.1 Procurement and Contract Process

6.1.1 Procurement

The following observations are made.

(a) The Procurement Time Table had not been properly prepared relating to the Main Procurement Plan prepared for the year under review.

(b) With the objective of establishing a training school and a common testing laboratory, a land with a four storied building situated in Bulathsinhala area of the Kalutara district which had been mortgaged to state bank had been purchased at a cost of Rs.88 million during the year under review. The following observations are made in this connection.

(i) The objective of establishing a common testing laboratory and a training school had not been included in the Action Plan.

(ii) Even though the Board of Director had decided that a Special Technical Evaluation Committee should be appointed for the preparation of a financial and feasibility report relating to the aforesaid purchase, action had not been taken either to appoint a Special Technical Evaluation Committee or prepare a financial and feasibility report.

(iii) Since it had been included in the newspaper advertisement published relating to calling for bids that the property which is expected to be purchased should be situated within 5 kilometers from the Bulathsinhala , the Corporation had not taken action to ensure fair, equal and maximum opportunities for the qualified and interested parties to participate in the procurement. Similarly, the Standard Bidding Documents had not been utilized as required by Guideline 5.3.1 of the Government Procurement Guidelines and as such, it could not be compared each other the presented two bids and it had not been considered by the Technical Evaluation Committee and the Procurement Committee. Further, in terms of Guideline 6.3.3 and 6.3.6 of the Government Procurement Guidelines, a bid opening committee had not been appointed and the activities pertaining to the opening of bids had not been recorded in a prescribed format. It was observed according to the above reasons that the procurement had taken place devoid of the competitiveness and transparency.

(iv) Without following the requirements such as obtaining an opinion/clarification from the Legal Division of the Ministry of Health, Nutrition and Indigenous Medicine regarding the relevant property, obtaining a Certificate of Completion –COC for the building from the relevant Local Authority through the seller, obtaining details of the mortgage-deed regarding the land with the building from the relevant bank branch and obtaining a Structural Report of the building either from the State Engineering Corporation or Central Engineering Consultancy Bureau as recommended by the Technical Evaluation Committee to carry out before making the above purchasing, the bidder who had presented the minimum bid had been selected as the prospective bidder by the Procurement Committee of the Department.

(v) If this matter was discussed with the bank branch to which the land with the building had been mortgaged, it could have been aware of the fact that the value of the final determination was Rs.66 million and that the relevant bank had decided to auction the above land. Nevertheless, due to failure in taking action accordingly, it had led to miss the opportunity to discuss with the seller to purchase that property at an amount less than Rs.88 million spent for the purchasing.

(vi) According to the report obtained by the seller from a Structural Engineer and presented to the Corporation, the Structural Report obtained by the Corporation from a Structural Engineer and the physical inspection carried out by Audit in order to examine as to whether the building expected to be purchased would be suitable for the establishment of a laboratory and a training school, systems for the prevention of water leakage in the roof slab area of this building had not been established and that area had directly exposed to the elements, thus resulting cracking on the walls of the downstairs due to extreme temperature. Cracking could be observed on the walls of the third floor and a railing had not been fixed on the staircase. In order to rectify these defects and renovate the building to suit to the training school, the Departmental Procurement Committee had awarded a contract worth Rs.33,460,608 on 08 May 2018.

(vii) The seller had not obtained a Certificate of Conformity –COC from the relevant Local Authority on completion of the construction of this building.

(c) The Corporation had purchase 10 Laptops costing Rs.1,680,550, two air-conditioners costing Rs.307,812, an electric Forklift costing Rs.5,907,895, two service tanks costing Rs.850,000 and an Analytical Balance costing Rs.559,417 under the shopping method. The following observations are made in this connection.

(i) Steps that should be taken in the purchase of goods under the shopping method such as using the Standard bid document No. NPA/SBD/GOODS/01, appointing a bid opening committee and reporting the bid opening in the prescribed format had not been taken as required by the Guidelines 5.3.1, 6.3.3 and 6.3.6 of the Government Procurement Guidelines respectively.

(ii) In terms of Guideline 8.9.1 (b) of the Government Procurement Guidelines, a formal agreement had not been entered into relating to the above goods and services contracts, the value of which had exceeded Rs.500,000.

(iii) In the procurement of the electric Forklift machine, bids had been called for from six bidders and only two of them had presented bids. Those bids had been rejected due to quoting higher prices. In terms of Guideline 7.12.3 of the Government Procurement Guidelines, if lack of effective competition is evident, which results in rejection of all bids received and wider publicity must be given when re-inviting bids. Nevertheless, instead of giving a wider publicity, the Technical Evaluation Committee had recommended to re-invite bids from the same bidders and the contract had been awarded to the only bidder who had responded to the second invitation of bids. Since action had not been taken to give wider publicity and call for bids from new suppliers, a limited competitiveness was observed.

(d) Although the spare parts costing Rs.1,258,211 for the Fluid Bed Granulator Dryer and accessories costing Rs.2,560,495 for New Capsule Filling machine had been purchased from there manufacturing institutions under the direct purchasing method, an agreement had not been entered into with the suppliers and without obtaining a bank guarantee, the total amount had been paid to the suppliers under the Telegrapic Transfer method. Even though periods of 06 months and 05 moths had elapsed by 08 June 2018, the date of audit from the date of payment respectively, goods had not been supplied to the Corporation and as a result of failure in entering into a contract agreement, it had not been possible to take any action for not supplying the goods and the losses caused due to delays.

6.1.2 Deficiencies in Contract Administration

For the construction of a building at a total cost estimate of Rs.242,268,015, a consultation firm had been selected on 27 August 2015 and a contractor had been selected on 01 September 2017 for carrying out Pilling Work of the building at a cost of Rs.22,755,500. The following observations are made in this connection.

(i) The services of the consultation firm selected for this construction being dissatisfied, the Board of Directors had decided on 06 April 2018 to terminate the agreement entered into with the above consultation firm. The agreement entered into with the consultation firm had not been made available to Audit.

(ii) In selecting a contractor for the Pilling Work of this building , a bid opening committee had not been appointed as required by Guideline 6.3.3 of the Government Procurement Guidelines and the proceedings of the opening of bids had not been recorded in the prescribed format in terms of Guideline 6.3.6 of the above Guidelines. Further, a formal agreement had not been entered into regarding this contract as required by Guideline 8.9.1 (a) of the aforesaid Guidelines.

(iii) According to the letter dated 01 September 2017 pertaining to the award of the contract, filling works should have been completed on 20 January 2018, whereas works had not been completed even by 15 May 2018.

6.1.3 Delayed Project

Constructions of 02 buildings, the total contract value of which amounted to Rs.144,805,967 were scheduled to be completed on 06 March 2017 and 02 August 2017 respectively according to the letter of awarding the contract. Nevertheless, works had not been completed even by 20 May 2018.

6.2 Tabling Annual Reports

The Annual Report for the year 2016 had not been tabled in Parliament even by 29 June 2018.

6.3 Unresolved Audit Paragraphs

As it had been revealed on 07 June 2016 that the 210 kilograms of "Cloxacillin Caps BP 500 mg" raw materials costing Rs.827,873 imported in the preceding year had contained the Fiber particles, it had not been possible to utilize the above stock. Nevertheless, the Corporation had not made request from the supplier to reimburse the loss even by 07 February 2017 and after 08 months from the recognition of the loss, request had been made to the local agents to reimburse the loss and it had been turned down by the local agents. The local agent had informed that the relevant supplier company had liquidated the business activities. Although the Chairman of the Corporation had expressed to the Audit on 20 June 2017 that a primary agreement had been reached with the supplier to recover the loss, steps had not been taken accordingly even by 13 July 2018.

7. Systems and Control

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.

	Areas of Systems and Controls	Observations
(a)	Non-current Assets	Failure in taking action to dispose of unusable assets.
(b)	Stock Control	Not maintaining the optimum stock levels.
(c)	Staff Administration	Making recruitments without obtaining the Treasury approval and not properly recording the arrival and departure.