Securities and Exchange Commission of Sri Lanka - 2012

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1. Financial Statements

1.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Securities and Exchange Commission of Sri Lanka as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.2 Comments on Financial Statements

1.2.1 Sri Lanka Public Sector Accounting Standards

Following observations are made

(a) According to the Sri Lanka Public Sector Accounting Standard-1, an asset shall be classified as current asset when it is expected to be realized within twelve months after the reporting date. Nevertheless, accumulated amount of Rs. 1,827 million which has been invested on Treasury Bills using the Cess Fund and not expected to be realized within twelve months after the balance sheet date had been shown in the financial statements as current assets.

(b) According to the Sri Lanka Public Sector Accounting Standard -7, the depreciation policy for depreciable leased assets should be consistent with the depreciable assets that are owned. However, different depreciation policies had been applied for the owned and leased motor vehicles of the Commission. As a result, depreciation expenses for the motor vehicles had been overstated in the financial statements by Rs. 540,500.

1.2.2 Accounting Deficiencies

The cost of leased motor vehicles, which were disposed of during the preceding year, had not been adjusted in the financial statements. Therefore, the values of motor vehicles amounting to Rs. 3,800,000 and accumulated depreciation thereon had been overstated in the accounts.

1.2.3 Lack of Evidence for Audit

Inventories amounting to Rs.628,884 could not be satisfactory vouched in audit due to the non-availability of the verification physical reports.

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

The following instances of non- compliance with Laws, Rules and Regulations were observed in audit.

Reference to Laws, Rules, Regulations and Management Decisions.	**Non-compliance**
(a) Finance Act No 38 of 1971	
(i) Section 8 (1)	A budget for the year under review had not been prepared not later than three months prior to the commencement of the financial year.
(ii) Section 14(1)	A draft annual report for the year under review had not been prepared indicating performance of the Commission submitted to the Auditor General along with the financial statements for the year under review.
(b) Public Enterprise Guidelines for Good Governance Circular No.PED/12 of 2 June 2003.	
(i) Section 4.2.2 of Chapter 4	The Commission should be periodically reviewed its corporate plan and budget to ensure the actual performance. However, no performance evaluating system had been established by the Commission.
(ii) Section 7.2 of Chapter 7	The Commission should have its own systems/manuals covering all the major

	operations. However, no any system/manual had been formulated.
(iii) Section 9.12 of Chapter 9	Even though any welfare scheme adopted by a public enterprise should have the approval of the General Treasury, the Commission had not obtained the necessary approval for the Employees' Medical and Insurance Welfare Scheme. The Chairman of the Commission informed me on13 September 2013 as follows. "In terms of the SEC Act Section 43 (2) the officers and servants can be appropriately remunerated by the Commission. The former Secretary to the Treasury had also granted approval to SEC indicating that the Commission is free to recruit staff and fix their salaries and emoluments without being subject to Government rules and regulations as per the attached directive."
(iv) Section 9.14 of Chapter 9	The manual of procedures with a chapter on human resource management providing rules and regulations on all matters relating to management of human resources should be approved by the Board together with the concurrence of the Secretary to the Treasury. However, the Commission had failed to comply with this requirement.

(c) In addition to the above non compliances, the Commission had not followed instructions and directives given in the Government circulars and other rules and regulations that are related to the public institutions. However, the Commission had not obtained the required approval of the Cabinet of Ministers in order to deviate from the government rules and regulations. In addition, there was no such a provision to exempt the Commission in the Securities and Exchange Commission of Sri Lanka Act No. 36 of 1989.

1.2.5 Unauthorized Transactions

Even though the Committee on Public Enterprises (COPE) has directed to obtain the Treasury approval for the payment of bonus, without obtaining said approval, payment of bonus has been continued. Annual bonus payment to the staff for the year under review was Rs. 9,893,659.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the operations of the Commission for the year ended 31 December 2012 had resulted in a net deficit of Rs.206,497,805 before taking into account the transfers from the Cess Fund for the operational expenses as compared with the corresponding net deficit of Rs. 184,993,953 for the preceding year. The net surplus for the year under review after taking into account the transfers from the Cess Fund for the year amounted to Rs.12,024,832 as compared with the corresponding net surplus of Rs. 7,401,390 in the preceding year after taking into account the transfers from the Cess Fund for that year, thus indicating an increase of Rs.4,623,442 in the net surplus.

2.2 Analytical Financial review

The revenue of the Commission for the year under review was Rs. 255 million including transfers from the Cess Fund to meet operational expenses amounting to Rs.218 million as compared with Rs.235 million, including transfers from the Cess Fund amounting to Rs. 192 million, in the preceding year representing an increase of 8.5 per cent in the total income. Whereas the expenditure incurred for the share market development activities during the year under review was Rs. 244 million when compared with Rs. 228 million of the previous year. Thus indicating an increase of 7 per cent. The changes of the revenue and expenditure of the Commission during the year under review, as compared with the preceding year are shown below.

	2012	**2011**	**Change**	
	Rs.(M)	Rs.(M)	Rs.(M)	%
Transfer from Cess Fund	219	192	27	14
Broker License fees, administration levy and educational programmes	21	29	(08)	27
Sundry income	16	14	02	14
Personal and administration cost	219	187	32	17
Capital market development expenses	24	41	(17)	41
Excess for the year	12	07	05	71

Personal cost had increased from Rs.114 million, in the preceding year, to Rs. 140 million in the year 2012, by 23 per cent. However, capital market expenses were decreased from Rs.41 million, in the preceding year, to Rs. 24 million during the year under review by 41per cent.

2.3 Working Capital Management

Significant ratios relating to working capital management as compared with preceding year is given below.

Ratios	Standard ratio	2012	2011
Current ratio	Not determined	23:1	23:1
Quick ratio	-do-	23:1	23:1

excluding Cess fund.

3. Operating Review

3.1 Performance

3.1.1 Performance of the share market

Some of the information relating to the share market of the country for the year under review and preceding four years are as follows.

	2012	2011	2010	2009	2008
Total turnover (Rs. Billion)	214	546	570	142	110
Domestic (Rs. Billion)	161	487	465	99	51
Foreign (Rs. Billion)	53	59	105	43	59
Share volume (Number of shares in million)	9,691	24,544	18,489	4,763	3,155
Daily average turnover(Rs. million)	884	2,285	2,396	593	464

With the end of civil war situation of the country in the year 2009, turnover of the share market had significantly increased by 301 per cent compared with the preceding years, recording a share turnover of Rs. 570 billion. However, that trend had sharply downturn by 60 per cent during the year under review declining the turnover from Rs.546 billion in 2011, to Rs. 214 billion in 2012. Further, volume of shares dealing at the share market had also reduced by 61 per cent from 24,544 million shares in 2011, to 9,691 million shares in 2012.

3.1.2 Capital Market Development Activities

Significant delay had been observed in audit with regard to achievement of targets stipulated in the corporate plan and in the action plan. Details are given below.

(a) Capital Market Development and Research:

(i) The Commission had planned to encourage State Owned Enterprises (SOEs) and large Corporate to issue equity or debt securities, and to simplify and streamline of issuing process for corporate bonds to encourage more issues together with the Colombo Security Exchange (CSE) and Registrar of Companies. However, actions had not been taken to initiate the programmes.

(ii) To encourage the superannuation funds to increase the Capital Market exposure of Colombo Stock Exchange (CSE), it had been planned to conduct a forum for superannuation fund trustees in 2011. However it had not been conducted even up to August 2013.

(iii) Although it had been planned to develop the Bond Market by liaise with Colombo Stock Exchange by encouraging Debt Trading system (DEX), only the representation were made to the CSE to change the DEX system up to 31 August 2013.

(iv) Although the Commission had targeted to complete the Demutualization of Colombo Stock Exchange in 01st Quarter 2011, to facilitate the improvements in the capital market infrastructure, the work had not been finalized even up to end of August 2013.

(v) The Commission had targeted to regulate the Investment Banks to strengthen the regulatory frameworks, and had delayed to complete the task till amending the SEC Act. Further, a proposal had been made by the Department of Labour to mandate the private pension funds having Rs. 500 million asset base to obtain the services of a SEC registered Investment Manager and it was postponed by the SEC to make representation at a more appropriate time.

(vi) Although Establishment of a Clearing Corporation with Colombo Stock Exchange had been targeted to complete by the end of 2010, it had not been completed even up to August 2013 after a delay of two and a half years.

(b) Corporate Affairs:

The task of formulating a scheme in collaboration with Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB) to initiate a process for independent review of the work done by the auditors of the listed companies was further delayed due to shortage of staff. The Chairman of the Commission informed me on 13 September 2013 as follows. "The Sri Lanka Accounting and Auditing Standards Monitoring Board was not in favor of signing an agreement with the Securities and Exchange Commission of Sri Lanka in relation to a scheme and to meet regulatory needs. The SEC was reviewing the possibility of creation of a panel of external auditors or drafting guidelines to register auditors of listed companies".

(c) Investigations:

Improvements of the data base on investigations by using IT inputs had not been initiated as per the Corporate Plan. The Chairman of the Commission informed me on 13 September 2013 as follows. "The budgetary requirements had been conveyed to the Finance and Administration Division and the necessary discussions were held with the Manager Information Technology. The time line had been extended to 1st quarter (1Q) of 2014."

(d) Supervision:

Implementation of E- filing for managing companies of Unit Trust and developing a reporting framework with the external auditors of the licensed/registered entities with the assistance of Sri Lanka Accounting and Auditing Standards Monitoring Board/Institute of Chartered Accountants of Sri Lanka (SLAASMB/ICASL) had been delayed over for three years.

(e) Surveillance:

Formulation and incorporation of a database on directors and insiders which was expected to be completed by early 2010 had not been completed even up to August 2013. The Chairman of the Commission informed me on 13 September 2013 as follows. "This was considered impractical as the SEC had to formally request for personal information of directors of listed companies pertaining their related parties. Besides at this point the SEC did not have any legal basis under which the SEC could request all directors to submit the required information. At the current stage of development of the Colombo Stock Exchange (CSE), where the SEC was trying to attract new companies to list, this would be perceived as another barrier or hurdle to new listing. It would also be a deterrent for people to serve on the boards of listed companies as directors. This could also be portrayed as a negative factor that prevents the CSE from recovering from the current downturn. As at this point, this had been abandoned and would not be revisited in the near future".

(f) Legal and Enforcement:

(i) Finalization of new Takeover and Mergers code, establishing a legal framework to enable the Demutualization of the Colombo Stock Exchange and Amendments made for the Securities and Exchange Commission Act were still in the draft level and had recorded a significant delay.

(ii) Proposals of e-filling for Market Intermediaries Credit Rating Agencies, Investment Managers, Underwriters and Margin Providers had not been implemented though it had been planned to complete during the year under review.

3.2 Quality and Reliability of Management Information System

Even though a sum of Rs. 72.4 million had been spent to acquire the computer hardware and software during the year under review and previous years, no proper system and information technology policies had been implemented after identifying the information requirements and controlling requirements of the Commission.

3.3 Matters in Contentious Nature

According to the Securities and Exchange Commission of Sri Lanka Act, actions should be taken in timely manner against the detections in order to minimize the violations such as price manipulation, insider/related party dealings, unethical conduct by brokers etc. However, out of the 147 cases identified by the Commission during the last three years, including 54 cases identified during the year under review, through the Surveillance Division and the Colombo Stock Exchange, only 40 cases were warranted for further investigations by the Surveillance/ Investigation Committee. As per the response received from the Commission, out of that, only 25 investigations had been completed and 11 files were closed by end of August 2013. However, significant delays were observed particularly in the investigation process.

3.4 Identified Losses

Profit from disposal of two motor vehicles which were assigned to two officers amounting to Rs. 3,772,362 had been transferred to the respective Officers instead of being accounted for as income of the Commission. Also, the required approval of the Cabinet of Ministers had not been obtained to transfer the profit to the Officers personally.

3.5 Contract Administration

Need definition, option analysis, identification of stages in procurements and preparation of estimates had not been carried out by the Commission as per the tender guidelines, when it made procurements.

3.6 Human Resources (HR) Management

Following observations are made.

(a) A HR plan and manual of procedure relating to HR management had not been prepared by evaluating the proposed development activities of the Commission.

(b) Effective action had not been taken to implement the proposal made in the Corporate Plan to introduce a Human Resources Information System.

(c) Annual total compensation review had not been done as a part of the performance evaluation system.

(d) According to the information made available to audit, number of employees of the Commission made under 07 service categories, were 82 and 72 for the year under review and the preceding year respectively. Sums of Rs.140 million and Rs.114 million had been spent by the Commission for salaries, wages and other allowances of the employees during the year under review and preceding year respectively. Thus indicating that the cost per employee for the year under review and the preceding year were Rs. 1,711,110 and Rs. 1,583,647 respectively.

3.7 Utilization of Vehicles

Following observations are made

(a) According to the information made available to audit, a sum of Rs.1,747,453 had been spent for the fuel, maintenance and repair of 06 vehicles during the year under review. Distance traveled during the year under review was 66,384KM. Thus indicating that cost per KM travelled during the year under review was Rs.26.32.

(b) A sum of Rs. 8,621,638 had been spent on reimbursement of fuel expenses and vehicle allowances to the Directors of the Commission during the year under review.

4. Accountability and Good Governance

4.1 Corporate Plan

A corporate plan for the Commission for 2010 to 2012 had been prepared. A new plan had been prepared for the year under review covering the period of 2012 to 2014 revising the above plan. However, some of the major activities which scheduled to be completed during the year under review had not been implemented.

4.2 Action Plan

The action plan had been amalgamated with the corporate plan without specifying the annual targets scheduled to be completed during the year under review.

4.3 Internal Audit Functions

Internal audit functions of the Commission had been given to a private audit firm. However, internal audit plan had not been furnished to the Auditor General in terms of Section 13(5) (d) of the Finance Act No 38 of 1971.

4.4 Audit and Management Committee

Three meetings were held during the year under review and recommended to introduce a policy for information technology management. However, a policy for information technology had not been introduced up to end of May 2013.

4.5 Procurement Plan

A procurement plan had not been prepared analyzing the required procurement of the Commission.

4.6 Budgetary Control

Following observations are made

(a) A sum of Rs.11.1 million had been spent for capital nature during the year under review. However, a detailed budget for capital expenditure had not been prepared.

(b) Significant variances were observed between the estimated expenditure and the actual for the year under review, thus, indicating that the budget had not been made use of as an effective instrument of management control.

5. Systems and Controls

Observations made in systems and controls during the course of audit were brought to the notice of the Chairman of the Commission by my detailed report issued in terms of Section 13 (7) (a) of the Finance Act. Special attention is needed in respect of the following areas of control.

a) Budget.
b) Preparation of monthly bank reconciliations.
c) Human resource management.
d) Procurements.
e) Accounting.
f) Information Technology management.