

## **Natwealth Securities Limited -2019**

### **1.1 Opinion**

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The audit of the financial statements of the Natwealth Securities Limited (“Company”) for the year ended 31 December 2019 comprising the statement of financial position as at 31 December 2019 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, 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 provisions of the National Audit Act No. 19 of 2018. My comments and observations which I consider should be report to Parliament appear in this report.

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

### **Emphasis of Matter**

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Without qualifying my opinion, I draw attention to Note 1.2 to the financial statements. As stated in the above note, the Company’s parent undertaking and controlling party is Mahapola Higher Education Scholarship Trust Fund (MHESTF) which is operated by Government of Sri Lanka. The Cabinet of Ministers at its meeting held on 28<sup>th</sup> August 2018 has taken a decision to liquidate the National Wealth Corporation Limited and sell the NatWealth Securities Limited to another investor under the approval of Central Bank of Sri Lanka. However, a fresh Cabinet Memorandum dated 26<sup>th</sup> February 2020 has been submitted to amend the above cabinet decision as sell only 49 per cent share capital of NatWealth Securities Limited and to suspend the liquidation of National wealth Corporation Limited until the restructuring process of NatWealth Securities Limited is completed.

Further, the Monetary Board of the Central Bank of Sri Lanka (CBSL) has suspended the Company from carrying on the business and activities of a Primary Dealer for a period of six months with effect from 31 May 2019. On 30<sup>th</sup> November 2019, CBSL has revoked the above suspension for a period of six months. Again, the CBSL has suspended the Company from carrying on the business and activities as a Primary Dealer for a period of 6 months with effect from 01 June 2020.

### **1.2 Basis for Opinion**

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I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **1.3 Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Company is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Company.

### **1.4 Audit Scope**

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My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or

conditions that may cast significant doubt on the Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

The scope of the audit also extended to examine as far as possible and as far as necessary the following;

- Whether the organization, systems, procedures, books, records and other documents have been properly and adequately designed from the point of view of the presentation of information to enable a continuous evaluation of the activities of the Company, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Company has complied with applicable written law, or other general or special directions issued by the governing body of the Company;
- Whether the Company has performed according to its powers, functions and duties; and
- Whether the resources of the Company had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

## 1.5 Financial Statements

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### 1.5.1 Unauthorized Transactions

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<b>Description of unauthorized transaction</b>	<b>Comment of the Management</b>	<b>Recommendation</b>
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(a) Company had revealed irregular transaction were done by the former CEO and former chief Dealer of the Company along with two companies namely Trillion Securities (Pvt) Ltd, and Virtual Investment & Trading Lanka (Pvt) Ltd. Even though the investment decision should have been taken by the investment committee of the company, the above officers had been taken investment decision for the transaction without obtaining any approval of the company.	It is our view that NWSL is not mandated to honor fraudulent transactions carried out by its staff in convenience with conflict with of interest.	It is recommended that all the investment decision should have been taken by the investment committee of the company and should take action about that matter immediately.

- (b) The Central Bank of Sri Lanka (CBSL) had issued a directive on 07 August 2015 Company instructing that to honour all dues arising from repurchase transactions to the said clients in terms of master repurchase agreement with the above two clients in terms of powers vested by Regulations 11(2) of the Local Treasury Bills (Primary Dealers) Regulations No.01 of 2009 dated 24 June 2009 and Regulations 11(2) of the Registered Stock and Securities (Primary Dealer) Regulations No. 01 of 2009 dated 24 June 2009. Since the CBSL had not revoked this directive, the Company is responsible to act accordingly.
- (c) The Company had filed an appeal in the Court of Appeal on 18 August 2015 against the directive made by the CBSL and the Court of Appeal had issued an interim order stating that to not implement said directive until 04 September 2015. However, after considering the requests made by the all responded parties, the above interim order had been withdrawn by the Court of Appeal on 29 March 2016. Subsequently, the Company had made another appeal in the Supreme Court on April 2016 by challenging the judgement delivered by the Court of Appeal. But no judgment had been delivered in favor of the Company by the Supreme Court. Nevertheless, the Company had submitted the Forensic Audit Report to the CBSL on 27 December 2016. However Trillion
- Both these relate to action being taken on the direction dated 07<sup>th</sup> August 2015 issued by the Monetary board of the Central Bank of Sri Lanka. We wish to draw attention to the supreme court case judgement of 29<sup>th</sup> July, 2016, wherein to notify NWSL before taking any step to suspend for any other action under clause 12 of the regulations and to give NWSL an opportunity to be heard before any such action is taken. The professional legal opinion from our representative Legal President's Counsel Mr. Ronald Perera was submitted to your Dept. with our letter dated 25<sup>th</sup> October 2017. We also note that CBSL has not given any direction or instruction to contrary, since the final Supreme Court case judgement on 29<sup>th</sup> July 2016 & receipt of the Forensic Audit Report on 27<sup>th</sup> December 2016. Company received the judgment on 02 November 2018 to the case filed by Trillion Securities Ltd. But no judgment had been delivered in favor of the Company by the high court. Therefore the Company had filed an appeal in the Supreme Court on 16 November 2018.
- It is recommended that to get an urgent decision from CBSL about this matter.
- It is recommended that the company wants to make provision with the settlement amount and the interest amount in the next year final accounts.

Securities Pvt ltd filed the case against the company. The judgement had received on 02 November 2018. According to the high court judgement, company wants to settle Trillion Securities Pvt Ltd the amount of Rs of 53,830,745 along with the interest rate of 14 percentage per annum from 25 July 2014 and the amount of 72,519 along with the interest rate of 14 percentage per annum from 31 July 2014.

- (d) The Company had made a complaint in the Criminal Investigation Department (CID) during the year 2016 in respect of unauthorized brokerage fees amounting to Rs.19,725,000 paid to two companies (White Grove Holdings and Astral Capital Holdings) in 2014. It was further observed that the Company had not got confirmed whether these companies had registered at the CBSL as financial companies before making the payment.
- We made a complaint at the CID in 2016, to investigate the beneficiaries of these unauthorized brokerage fees. It is recommended to take an immediate action about this matter.

#### 1.6 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Comments of the Management	Recommendation
Public Enterprises Circular No PED 12 of 02 June 2003, Section 9.1	The Company should have a cadre with appropriate skills to maximize productivity of its employees. However, the Company's cadre had not been approved from the Board of Trustees of Mahapola Higher Education Trust Fund.	The cadre of the Group of Companies approved by the Board of Directors was submitted to the Board of Trustees of Mahapola Higher Education Scholarship Trust Fund. We are awaiting to receive the approval	Company need to comply with this regulation

## 1.7 Non -compliance with Tax Regulations

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### Audit Observation

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### Comment of the Management

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### Recommendation

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- (a) The Company had received an income tax assessment for the year of assessment 2008/2009, 2009/2010, 2010/2011, 2011/2012, 2013/2014, 2014/2015 and 2015/2016 to the value of Rs. 24,136,857, Rs. 77,382,317, Rs. 84,378,708, Rs. 66,181,759, Rs. 18,288,933, Rs. 113,687,212 and 36,466,487 respectively from the Department of Inland Revenue. The Company has appealed against the said notice of assessment issued by the Commissioner General of Inland Revenue. The Department of Inland Revenue may impose 50 % penalty on the above assessments.
- According to the second provision to section 32(1) if the Inland Revenue Act, the interest income from government securities, if tax has been deducted on such securities for “primary market” transactions, the relevant interest income shall not be considered as business receipt for the purpose of computing statutory income. Therefore, income tax assessments issued were disregarded due to the specific provision.
- The Company should rigorously follow up with the Commissioner General of Inland Revenue to resolve the tax. The Board of Directors should reassess its tax position on the assessment based on the advice of its tax consultants and necessary adjustments, if any should be made in the financial statements.
- (b) The Company had received notice of assessment for Value Added Tax on Financial Services for the year of 2013 to the value of Rs. 16,600,601 and year of 2014 to the value of 58,097,943 from the Department of Inland Revenue. The Company had appealed against the said notice of assessment issued by the Commissioner General of Inland Revenue. The Department of Inland Revenue may impose 50 % penalty on the above assessments.
- The company does not pay VAT under section 25(A) as the management is of the opinion that the company is not in the business of providing financial services.
- The Company should rigorously follow up with the Commissioner General of Inland Revenue to resolve the tax.

## 2. Financial Review

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### 2.1 Financial Result

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The operating result of the year under review amounted to profit of Rs. 224,420,525 and the corresponding loss in the preceding year amounted to Rs. 243,412,073. Therefore an improvement amounting to Rs 467,832,598 of the financial result was observed. The reasons for the improvement are decrease in interest expense by Rs. 284,376,048 and gain from revaluation of dealing securities by 319,772,260.

## 2.2 Trend Analysis of major Income and Expenditure items

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Major income and expenditure items of the year under review compared with the preceding year

- a) Interest expense of Rs 119,096,047 for the year 2019 in comparison to the preceding year Interest expense of Rs 403,472,095, thus showing a decrease of 70 percent in interest expense of the company.
- b) Gain from revaluation of dealing securities of Rs 152,014,625 for the year 2019 as compared with the preceding year of Loss from revaluation of dealing securities of Rs 167,757,635, thus showing an increase of 190 percent in revaluation of dealing securities.

## 3. Operational Review

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### 3.1 Operational Inefficiencies

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#### Audit Observation

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Monetary Board of Central Bank of Sri Lanka decided to revoke the suspension of business and activities of company as a primary dealer for a period of six month with the conditions of complete the ownership restructuring plan of company and the progress of the implementation to be reported to the central bank monthly until the completion of restructuring plan, Restriction of the Board of Directors to resign from the board until the restructuring is completed, Company complying with all relevant laws, regulations and guidelines at all time and effectively participating in primary and secondary market transaction in government securities and rectification of supervisory concerns raised at on-site examination. However company has failed to comply with the conditions and company is suspended from carrying business activities as a primary dealer for a period of 6 months.

#### Comment of the Management

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The company was unable to comply with the conditions because the company was unable to proceed with the expected restructuring plan due to the prevailing situation in the county and company was unable to contact the Ministry of Higher Education, Technology & Innovations to obtain new cabinet decision, Chairman and one director have resigned from Board of Directors since the Secretary to the President has directed all the Secretaries to the Ministries to request the resignation of Chairperson and Board members of the organizations, the participation of primary and secondary market considerably low after the revocation of suspension reflecting its failure to sustain its role as a primary dealer and the company has rectified the operational risk concerns which were raised at the on-site examination due to its low transaction volume during the period after the revocation of suspensions.

#### Recommendation

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It is recommended that the company should complete the ownership restructuring plan and take necessary steps to increase the participation in the primary and secondary market.

#### 4. **Accountability and Good Governance**

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##### 4.1 **Corporate Plan**

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###### **Audit Observation**

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The company had prepared the strategic business plan for the period of 2018-2020. However the revised strategic business plan had not been prepared based on the market conditions.

###### **Comment of the Management**

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Strategic business plan for 2018-2020 was prepared in latter part of the year 2017 based on the market conditions prevailed in that time and future forecasts. However a new budget was approved by the Board of Directors on 14<sup>th</sup> December 2018 for the year 2019 by considering the problem faced by the company.

###### **Recommendation**

The company should prepare the revised strategic business plan considering the market conditions.