

Securities and Exchange Commission of Sri Lanka - 2021

1. Financial Statements

1.1 Opinion

The audit of the financial statements of the Securities and Exchange Commission of Sri Lanka (“Commission”) for the year ended 31 December 2021 comprising the Statement of Financial Position as at 31 December 2021 and the Statement of Financial Performance, Statement of Changes in net assets 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 and Finance Act, No. 38 of 1971. 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 Commission as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

1.2 Basis for Opinion

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 opinion.

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

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector 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 Commission’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 intends to liquidate the Commission or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Commission’s financial reporting process.

As per Section 16(1) of the National Audit Act No. 19 of 2018, the Commission 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 Commission.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

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 skepticism 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 Commission'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 Commission'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 Commission 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 Commission, and whether such systems, procedures, books, records and other documents are in effective operation;
- Whether the Commission has complied with applicable written law, or other general or special directions issued by the governing body of the Commission;
- Whether the Commission has performed according to its powers, functions and duties; and
- Whether the resources of the Commission had been procured and utilized economically, efficiently and effectively within the time frames and in compliance with the applicable laws.

2. Financial Review

2.1 Financial Results

According to the financial statements presented, the operations of the Commission had resulted in a deficit of Rs.352.5 million before taking into account the transfers from the Cess Fund towards net operational expenditure and it was reported the deficit of Rs. 385.2 million for the preceding year. The main reason for decreasing the deficit by Rs.32.7 million or 8.4 per cent as compared with preceding year was the increase of grant received during the year under review by Rs. 93.1 million under the Financial Sector Modernization Project.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the Commission during the year under review, as compared with the preceding year are shown below.

	2021 ----- Rs.	2020 ----- Rs.	Difference as a percentage ----- %
<u>Income of the Commission</u>			
Interest Income	1,820,617	5,360,805	(66.0)
Government Grant (FSMP)	104,804,128	11,720,560	794.2
<u>Expenditure of the Commission</u>			
Staff Salaries	148,971,963	132,419,676	12.4
Special Payment	18,085,294	16,606,045	8.9
Staff Vehicle Allowance	26,662,653	23,298,500	14.4
Staff Medical Expenses & Insurance	15,350,619	7,914,882	93.9
Staff Welfare	7,335,081	4,052,758	80.9

Overseas Training and Travelling	0	2,309,872	(100)
Rent & Car Park Rental	101,143,670	96,216,435	5.1
Capital Market Development Expenses - Total	55,241,934	32,376,005	70.6
• Capital Market and Product Development	14,862,714	16,920,166	(12.1)
• Public Awareness Programmes	24,840,257	1,354,648	1,733.7
• Educational Programmes	1,802,431	1,609,193	12.0
• International Membership Fees – IOSCO	4,210,388	3,684,862	14.2
• Publicity and Advertising	146,664	0	100
• Market Surveillance Cost	9,349,152	8,795,002	6.3

- a. As part of the Financial Sector Modernization Project funded by the World Bank, the Commission stands to gain approximately USD 10 million; USD 2 million under result based financing component and USD 8 million under the Investment based financing component. As at the end of the year under review, the Commission received Rs.197.68 million in total (Rs. 81,124,254 in 2019 and Rs. 11,720,560 in 2020, Rs.104,804,128 in 2021) as part of Result Based financial component of the Project. According to the information made available, Commission had approved the amendments to the Central Depository System and other rules that are necessary to enable the settlement of the corporate equity segment on the Delivery Vs payment (DvP) basis which was required to be achieved under Disbursed Link Indicator 4.1 mentioned in the financing agreement of the project. However, other two disbursement link indicators of successful Colombo Stock Exchange Business continuity planning testing involving the DvP arrangement completed and Commission undertaking onsite or off site inspection/ audits one year after enabling DvP to ensure DvP is happening are yet to be completed as at end of July 2022.
- b. Capital Market and Product Development expenditure for the year under review was Rs. 14.86 million and it was 16.92 million in the previous year reflecting a decrease of Rs. 1.94 million or 12.1 per cent during the year under review.
- c. As per the Section 14B (2) (a) of the Securities and Exchange Commission Act (SEC Act) No. 36 of 1987, it is authorized to pay out of the Cess imposed under the said Act for the purpose of developing the securities market. Accordingly, a sum of Rs. 55,241,934 or 11.1 per cent of the total expenditure had been spent in the year under review for the capital market development activities and it was 11.8 per cent and 7.4 per cent in the years 2019 and 2020 respectively.

3. Operating Review

3.1 Observations on main operational matters

Audit Issue	Management Comment	Recommendation
a. Implementation of Delivery Versus Payment (DvP) in sequentially implementing the Central Counter Party Mechanism (CCP) was planned	The Commission wishes to inform that the implementation agency of the DvP system was the Colombo Stock Exchange (CSE) and the role of the Commission was to facilitate the process by guiding the policy formulation with	Need to complete the process as per the target period.

to complete at the end of first quarter of year 2018 and it was extended to first quarter of year 2019. However, implementation of the DvP settlement model had been in progress as at 31 December 2021.

the assistance of the DvP Expert, granting necessary approvals for the finalized policy and rules and expediting the implementation process.

Prior to the DvP implementation, the CSE had to ensure that broker back office systems were capable of making required modifications in line with the DvP and as a result all broker back office and order management systems had to be upgraded. It is important to note that the SEC's involvement in expediting the whole implementation process contributed immensely in completing the initiative by 16th August 2021.

The finalised CCP model and policy was approved by the board of directors of the CSE and the Commission and its completion is expected during the first or second quarter of 2023.

- b. A sum of Rs.36.1 million had been budgeted to the Capital Market and Product Development for the year under review which is authorized by the Section 14 B 2 (a) of the SEC Act No. 36 of 1987 to pay out of the Cess imposed under the said Act. However, a sum of Rs. 14.8 million or 41 per cent had only been incurred during the year under review for the said purpose.

With regard to capital market and product development, a sum of Rs. 36.1 million has been allocated and this was under three heads namely conducting road shows, payment for broker back and Order Management Systems and Promotional Campaign for Unit Trusts. These estimates had been made taking into consideration the plans the Commission had for these promotional activities. However, considering lockdowns, restrictions on crowd gatherings and travel restrictions, the expected activities could not be conducted.

Need to do these activities in alternative ways if possible.

3.2 Human Resources (HR) Management

----- Audit Issue -----	----- Management Comment -----	----- Recommendation -----
a. It was observed that the posts of Deputy Director General, Director Capital Market Development, Director Investigations, Director Supervision, Director Corporate affairs, Assistant Director legal and Enforcement and Assistant Director Capital	The Commission had called for applications and conducted interviews to fill all of the aforementioned vacancies. This being said, the Commission has not been able to identify suitable persons	Need to fill these vacancies within reasonable time.

Market Development which are under the approved Cadre as at 22 January 2018 were remained vacant for a considerable period as at 31 July 2022. Remaining vacant of key managerial positions may have been effected to the effective functioning of the Commission.

for these positions. Whenever, a suitable candidate was identified, such candidates have not been keen to take up the positions mainly due to the low salaries that were offered to them.

Even as of now, the Commission has called for applications and is in the process of conducting interviews to fill these vacancies.

- b. An officer attached to the Commission had been interdicted from service with effect from 19 April 2016. However, an amount equivalent to half of his monthly gross salary excluding transport allowances and other benefits was paid contrary to Sub-Section 31.11 of the Establishment Code of the Democratic Socialist Republic of Sri Lanka. The half month salary cost incurred by the Commission on behalf of him from 20 April 2016 to 31 August 2018 was Rs.5,212,815. As per the recommendation of the Committee on Public Enterprises (COPE) dated 18 September 2018, the Commission should stop paying salary and make arrangements to recover total paid salary. Accordingly, payment of half month salary was stopped with effect from September 2018 and the officer was informed to repay the above mentioned amount by letter dated 15 November 2018. However, it was not recovered by the Commission even up to 6 September 2022.

The Commission wishes to state that multiple written reminders have been sent to the Officer concerned requesting him to refund the aforesaid sum of Rs. 5.2 Million, although an acknowledgment has been sent by him, he has failed to reimburse the said sum. The disciplinary inquiry against him is still going on and the Commission on many occasions has requested both the inquiring officer and the parties to expeditiously conclude the inquiry.

Need to expedite the recovery process as per COPE direction.

3.3 Payment made for publicity campaign on the Colombo Port City

Audit Issue

Management Comment

Recommendation

According to the Section 13(k) of the Securities and Exchange Commission of Sri Lanka Act No.36 of 1987 as amended (Old

As per section 13(k) of the SEC Act No. 36 of the 1987 (as amended) which deals with the powers, duties and functions of the Commission, the Commission is empowered to

Act), the Commission has the power to implement the policies and programmes of the Government with respect to the market in securities. The commission has given the a sum of Rs. 8,821,948 during the year 2021 to the Secretary, State Ministry of Money and Capital market and State Enterprise reforms to which Commission was not in purview, as contribution of government advertising campaign for the purpose of creating awareness among general public on their prospects with Port City. This payment was requested by the Relevant Ministry on 15 April 2021 which was before passing the Colombo Port City Economic Commission Act, No. 11 of 2021 though payment was approved after it was passed.

advise the Government on the development of the securities market and to implement the policies and programmes of the Government with respect to the market in securities.

The State Ministry of Money & Capital Market and State Enterprises Reforms by its letter dated 15.04.2021 informed the Commission of the proposed campaign which was aimed at increasing the visibility of the Colombo Port City. Accordingly, the Ministry had requested the Board of Investment, Sri Lanka Tourism Development Authority and Commission to support the said campaign by indicating the cost. The Commission wishes to pointed out that according to the Colombo Port City Economic Commission Act No. 11 of 2021, the Port City Commission is empowered to “facilitate the establishment and operation, within the Area of Authority of the Colombo Port City, any stock, precious metal or commodity, exchange or market, to be operated by authorised persons, for trade in any designated foreign currency, subject to such terms, conditions and procedures as may be prescribed”. As such, it is clear that in the event a stock exchange is established in the Colombo Port City, the Commission along with the Colombo Port City Economic Commission will be required to develop and regulate such activity.

4 Accountability and Good Governance

4.1 Budgetary Control

Audit Observation	Management Comment	Recommendation
<p>Significant variances ranging from 27 per cent to 101 per cent were observed between budgeted and actual expenditure in 9 items during the year under review thus, indicating that the budget had not been made use of as an effective instrument of management control in those instances.</p>	<p>Certain activities planned by the Commission were not conducted due to the situation that prevailed in the country. As such, the budgeted amounts under certain headings have not been utilized. However, the expected expenditure in relation to travelling has exceeded the budget allocation by 101 per cent because the Commission decided to provide transport facilities in order to ensure the safety of the staff from contracting Covid-19. This also resulted in the vehicles of the Commission being used excessively. As a result, these vehicles had to undergo repairs due to the reason that they were in use for a significant period of time. Thus, major maintenance activities during the year under consideration resulted in a 27 increase in Vehicle Insurance & Maintenance costs.</p>	<p>Need to comply with the budget.</p>