

## Securities and Exchange Commission of Sri Lanka - 2010

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### 1. Financial Statements

#### 1.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, I am of opinion that the Securities and Exchange Commission of Sri Lanka had maintained proper accounting records for the year ended 31 December 2010 and the financial statements have been prepared in accordance with Sri Lanka Accounting Standards, give a true and fair view of the state of affairs of the Commission as at 31 December 2010 and the financial results of its operations and the cash flows for the year then ended.

#### 1.2 Comments on Financial Statements

##### 1.2.1 Accounting Deficiencies

Dividends amounting to Rs. 92,171,801 received for the year under review and reinvested in the State Institution Temporary Surplus Fund (SITSF) had not been taken into account at the year end. Therefore, the value of investments made in the SITSF amounting to Rs.360,255,392 shown in the financial statements under Cess Fund was not agreed with the balance amounting to Rs. 452,427,199 confirmed by the State Institutions Temporary Surplus Fund Manager. As a practice, the dividend received during the year by the Commission is shown as receivable at the year end and adjust the value of the investment in the subsequent year.

##### 1.2.2 Unexplained Differences

The balances aggregating Rs 23,642,191 in respect of three bank current accounts of the Commission shown in the trial balance at the end of the year under review had been erroneously taken into the bank reconciliation statement as Rs 23,435,131. Thus, the accuracy of the bank reconciliation statement prepared for such bank accounts could not be ensured in audit.

##### 1.2.3 Non- Compliance with Laws, Rules, Regulations and Management Decisions

In terms of MSD Circular No 30 of 22 September 2006 of the Management Services Department and PED/PE Circular Letter dated 08 July 2009 of the Department of Public Enterprises, all Public Enterprises should prepare their recruitment and promotion procedure in line with the salaries and promotion schemes stipulated in the Circular No 06/ 2006 of the Department of Public Enterprises. Further, the Commission had been requested by PED/PE Circular Letter dated 08 July 2009 to complete its recruitment and promotion procedures as enable to get the approval from the National Salaries and Cadre Commission before 30 July 2009. However, no action had been taken by the Commission even as at 30 April 2011 to

comply with the national policy on restructuring of salaries and cadre position of the public enterprises and the Chairperson of the Commission commented that Securities and Exchange Commission will make representation to the National Salaries and Cader Commission to facilitate a special structure for the Regulators such as SEC.

#### **1.2.4 Lack of Documentary Evidence for Audit**

Following observations are made.

- (a) Seminar income amounting to Rs 14,139,970 earned by the Financial Service Academy could not be satisfactorily vouched in audit due to lack of details of the course fees paid by individual participant either at the Financial Service Academy or Finance Division of the Commission. The break- up of the income earned by each course had not been furnished for audit at the information called for.
- (b) As approved by the Commission at its meeting held on 19 April 2010 the vehicle allowances for the Director General, Directors and Assistant Directors, unless they get the benefit to use leased vehicles, had been increased up to Rs 89,000 Rs. 65,000 and Rs, 35,000 respectively. However, the approval of the Ministry of Finance and Planning to increase the vehicle allowance had not been submitted to audit.

## **2. Financial and Operating Review**

### **2.1 Financial Review**

#### **Financial Result**

According to the financial statements presented, the operations of the Commission for the year ended 31 December 2010 had resulted in a net deficit of Rs. 191,084,798 before taking into account the transfers from the Cess Fund for the operational expenses as compared with the corresponding net deficit of Rs. 174,908,861 for the preceding year, thus indicating a increase of Rs.16,175,937 in the net deficit. The net surplus for the year under review after taking into account the transfers from the Cess Fund for the year amounted to Rs.4,694,399 as compared with the corresponding net surplus of Rs. 1,593,557 for the preceding year after taking into account the transfers from the Cess Fund thus indicating an increase of Rs.3,100,842 in the financial results.

## **2.2 Operating Review**

### **2.2.1 Human Resources Management**

Following observations are made.

- (a) It was observed that the staff of the Commission had comprised with the 70 officers at the end of the year under review when compared with 72 officers remained in the services at the end of the previous year. The post of Director, Legal and Enforcement had remained vacant for over two years and overseeing such duties by the Director General. In addition, the Commission had employed a person on contract basis for the post of Director, Human Resources up to July 2010 and suppressed that post subsequently by amalgamating the responsibilities to the Director, Finance and Administration. Further, the post of Director, External Relations and Market Development which was created in 2007 to implement the Master Plan for 2006-2015 of the Commission had also been suppressed even the Master Plan activities were not fully completed as at 31 December 2010. Further, two posts for Managers had remained in vacant for over three years.
- (b) As per the letter of the Secretary to the Ministry of Finance and Planning dated 31 March 1992, the Commission is privileged to recruit its staff and fix their salaries and other emoluments without considering other Government regulations. The Commission had taken action to offer the annual bonus amounting to Rs.6,064,446 in April and December 2010 based on the performance of the staff. Further, an ex-gratia allowance amounting to Rs. 3,269,349 had also been paid in December 2010 to the staff members of the Commission on the request made by the Directors of the Commission.

### **2.2.2 Deficiencies in achieving goals stipulated in the Corporate Plans**

Following observations are made.

#### **(a) Amendments to the Laws related to the Activities of the Securities and Exchange Commission**

As per the Corporate Plan for the years 2010 to 2012 of the Commission, the laws relating to the affairs of the Commission was expected to be amended to enable the Commission to supervise the stock market activities in prudent manner. Eventhough most of action in this regard had been initiated in first quarter of 2009 it had shown a poor progress as at 31 December 2010. Details are given below.

- (i) Draft memorandum to amend the Securities and Exchange Commission Act for the purpose of demutualization of the Colombo Stock Exchange had been forwarded to the Ministry of Finance and Planning and Legal Draftsman Department in March 2010. The issues relating to share ownership structure and governing structure etc had been discussing with the Colombo Stock Exchange at the end of the year under review.

- (ii) In addition, the proposals as enable to amend the Company Takeovers and Mergers Code had been included in the Corporate Plans since 2009 to modify the Code in order to keep it in line with the recent developments of capital markets locally and internationally. As explained by the Commission, several actions such as seeking guidance of a Hon. Judge of the Supreme Court of Sri Lanka and conducting review and comparative analysis on the laws relating to takeover and mergers prevailed in this country and other countries had been carried out. A sun of Rs 1,140,000 had been paid as the consultancy fees for this purpose in 2009 and 2010. However, actions taken by the Commission in this regard had remained in preliminary stages , at the end of the year under review.
- (iii) Further, actions taken to implement the proposals included in the Corporate Plan for for 2010-2012 such as to amend the Unit Trust Code to introduce rules for exchange traded funds and introduce the provisions to Securities and Exchange Commission Act to establish the Central Counter party and Sri Lanka Investors Association etc had shown a poor progress at the end of the year under review.The Chairperson has informed me that the finalized rules for the Exchange Traded Funds were incorporated into the Unit Trust Code and forwarded to the Legal Draftmen to gazette same.The establishment of the Investor Association was deferred in year 2010 and approved to include in the corporate plan for the year 2011.

**(b) Development of other Systems of the Commission**

The actions then by the Finance and Administration/ Human Resources Division of the Commission to implement the proposals made in the Corporate Plans since 2009 to develop internal systems of the Commission had not shown a satisfactory progress during the year under review. Details are given below.

- (i) Activities on developing an Administrative Manual of the Commission had been initiated in 2009. However, only the first draft of the Manual could be issued at the end of the year under review
- (ii) Fruitful actions had not been taken to implement the proposal made in the Corporate Plans to introduce a Human Resources Information System since 2009.
- (iii) Activities such as developing an internal faculty for sharing expertise, working out of organizational development plan and conducting an employee satisfaction survey etc, included in the Corporate Plans since 2009 had been further postponed.

### **2.2.3 Delays in Implementing the Decisions taken at the Commission Meeting**

Following observations are made.

- (a) As per the decision taken by the Members of the Commission at the meeting held on 22 May 2007, the Commission had made an advance amounting to Rs 7,213,638 on 30 December 2009 to a supplier selected through tender procedures to procure a system for automating of for market surveillance activities of the Commission.. As per the agreements entered by the Commission with the selected supplier ,the system was expected to be commissioned in mid 2010. However it was not in operation even as at 31 May 2011. Further , the Commission had taken action to appoint an IS Expert to carry out an user acceptance test on the surveillance system in September 2010. As per the Experts' report dated 14 March 2011 several weaknesses had been pointed out on hardware installation, storage systems, firewalls, staff training etc,In this regard Chairman of the commission stated that the syayem is in operation now and run both the old and new systems parallel until the system upgrade is completed.
- (b) The Commission had decided at it's meeting held on 24 March 2010 to conduct a survey access capital market awareness and publish the out come of the servay by October 2010.It was observed that the SEC had expensed a sum of Rs.1,003,000 to conduct the servay by using 51 undergraduates selected from seven universities.However, the outcome of the servay had not been published even as at 30 April 2011.

### **2.2.4 Matters in Contentious Nature**

Following observations are made.

- (a) (i) The former Director General of the Commission had entered into an Agreement dated 05 July 2007 with the Commission to serve obligatory period of four years with effect from 06 July 2008 on full -pay leaves taken for reading for Masters Degree in USA. According to the Paragraph 07 of the Agreement, the officer become liable to reimburse the full amount of expenses incurred by the SEC or an amount decided the Commission, in the event of resignation before the obligatory period of service. According to the information collected, a sum of Rs. 3,024,168 had been incurred by the Commission during to period of foreign study of the officer. However, the Commission had decided to recover only Rs. 61,500 and release the officer from the obligatory period of service ending 06 July 2012.
- (ii) It was observed that a sum of Rs.250,000 had been paid to the said officer on 01 February 2010 as a reimbursement of course fees incurred in July 2007 eventhough the Commission was not bound to provide any financial assistance for the course of study as per provisions made in the Paragraph 03 of the Agreement.
- (iii) Further, vehicle allowance amounting to Rs 89,411 had also been paid to the said officer for the months of May and June 2010 eventhough he had been released from all his duties , responsibilities and functions in the capacity of the Director General with effect from 30 April 2010.

- (b) As per the decision taken by the Board of Members of the Commission at the meetings held on 04 June 2002 and 28 October 2009, the leasing facilities for vehicles for the maximum of Rs 2.5 million to the Directors/ Assistant Directors of the SEC had been offered while providing the options to them to acquire the vehicle at the end of the lease period. Similar concessions had not been provided by other public sector organizations and as a result, several observations had been made in the audit reports issued in previous years. Matters pointed out in previous audit reports and action not taken to rectify those weaknesses are given below.
- (i) The Scheme had been implemented only on the decisions arrived at the Board Members of the Commission and the conditions for the facility included the appointment letters issued to the employees concerned. A separate set of rules for the Scheme had not been stipulated.
  - (ii) The approval of the Ministry of Finance and Planning had not been obtained for the scheme.
  - (iii) The concession had been granted to the employees to vest the ownership of the vehicle at the end of the lease period or during the lease period by paying outstanding lease rentals. However, limits for number of instances of entitlement for the concession had not been determined.

Following further observations are made.

- (i) According to the vehicle registration records, such leased vehicle had been registered under the name of the Commission. However, the respective officers had been allowed to make requests to the Commission to transfer the ownership of the vehicles to outside parties at the end of the lease period or settling leasing rentals at any occasion. In such manner, five vehicles had been transferred since 2005 to outside parties without receiving any financial gains to the Commission.
- (ii) It was observed that a Director who was employed by the Commission on contract basis had also enjoyed the facility since June 2008.
- (iii) The Committee on Public Enterprises (COPE) at its meeting held on 17 September 2010 had directed the SEC to furnish a separate report on vehicle leasing facilities. However, views of the Commission in this regard had been included in a report dated 31 December 2010 furnished by the Commission to the COPE on remedial action taken on the directions issued by the COPE instead of taking action to furnish a separate report.

### **2.2.5 Budgetary Control**

It was observed that the Commission had allocated a sum of Rs. 497 million under Capital Budget for 2010, and out of that Rs. 33 million only had been utilized due to delays in action taken for acquisitions/ of the buildings, and procurements of the equipments for surveillance system, office automation and motor vehicles etc. In addition, a sum of Rs. 287 million had been allocated under the Recurrent Budget to meet the costs on personnel, establishments, professional development, and capital market development purposes and out of that, Rs. 220 million had only been spent during the year under review due to over budgeting of expenses for maintenance costs on equipments, insurance, electricity, entertainment and local training etc and less number of activities carried out under capital market development purposes. Thus, indicating that the Budget had not been made use of as an effective instrument of management control.

### **3. Systems and Controls**

A detailed report in terms of Section 13 (7) (a) of the Finance Act No 38 of 1971 was furnished to the Chairperson of the Commission on 31 May 2011. More attention of the Commission should be paid to establish administrative procedures on provision of leased vehicle facilities, financial assistance for higher studies and other welfare benefits for the staff and ensure the accuracy on income received from cess collection and courses conducted by the Financial Service academy of the Commission.