

NatWealth Securities Limited - 2017

The audit of the financial statements of the NatWealth Securities Limited (“the Company”) 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 statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, 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.

This report is issued in terms of provisions in Article 154(6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Board’s Responsibility for the Financial Statements

The Board of Directors (“Board”) 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 Board 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. 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 Company’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 Company’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Board, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Company 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 Report on Other Legal and Regulatory Requirements

As required by Section 163(2) of the Companies Act, No.07 of 2007, I state the followings:

- (a) The basis of opinion and scope and limitations of the audit are as stated above.
- (b) In my opinion :
 - (i) I have obtained all the information and explanations that were required for the audit and, as far as appears from my examination, proper accounting records have been kept by the Company.
 - (ii) The financial statements of the Company comply with the requirements of the Section 151 and 153 of the Companies Act, No. 07 of 2007.

2.3 Non – compliance with Laws, Rules, Regulations and Management Decisions

The following instances of non-compliance with Sections 5.1, 9.2 and 8.3.3 of the Public Enterprises Circular No. PED/12 of 02 June 2003 was observed in audit.

- (a) A Corporate Plan had not been prepared by the Company since its inception.
- (b) The Company does not have an approved Cadre registered with the Department of Public Enterprises.
- (c) Even though a sum of Rs.5,050,011 had been paid as staff incentive during the year under review, the Company does not have an approved incentive scheme for the payment of such incentives.

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Company for the year under review had resulted the pre-tax net profit of Rs.163,361,553 as against the pre-tax net loss of Rs.499,587,470 for the preceding year, thus indicating an improvement of Rs.662,949,023 in the financial results for the year under review as compared with the previous year. Increase of investment income by Rs.433,400,507 as compared with the

previous year due to favourable market conditions was the main reason attributed to this improvement in the financial results for the year under review.

4. Operating Review

4.1 Performance

According to the Articles of Association of the Company, the primary objectives of the Company are: to carry on business as Primary Dealers, engage in secondary market transactions and do any acts which may be required to promote and develop a secondary market in Treasury Bills, Treasury Bonds, other government and Central Bank Securities.

However, A Corporate Plan or Strategies had not been prepared or set out since its inception of the Company in order to achieve these objectives. Further, an Action Plan also had not been prepared for the year under review. Hence, the performance of the Company for the year under review could not be ascertained in audit.

4.2 Identified Losses

In the event of decreasing interest rate, the Company could be able to earn a capital gain and unrealized profit from sale of its securities and fair valuation of its financial instruments respectively. However, the Company had incurred a capital loss of Rs.86,121,905 during the month of March 2017 even though the interest rate had decreased by 0.04 per cent with compared to the previous month. In this connection, the Chairman of Company had informed me that, according to the business decision taken by the senior management of the Company, the investment portfolio was reduced by selling its Treasury bonds at a loss.

4.3 Transactions of Contentious Nature

Even though the Company had received an income tax assessments aggregating Rs.384,055,786 for the previous six years assessment period commencing 2008/2009 from the Department of Inland Revenue, actions had not been taken to remit this tax to the Commissioner General of Inland Revenue even up to 18 July 2018. As a result 50 per cent of penalty totalling Rs.192,027,893 on delaying the payment had been imposed by the Department of Inland Revenue. However, the Company had made an appeal against the said assessments issued by the Commissioner General of Inland Revenue.

5. Accountability and Good Governance

5.1 Budgetary Control

Significant variances of Rs.14,317,648 and Rs.10,136,287 between the budgeted and actual net interest income and capital gain respectively for the year under review were observed in audit, thus indicating that the budget had not made use of as an effective instrument of management control.

5.2 Unresolved Matters pointed out in my Previous Audit Reports

The audit paragraphs included in my report issued for the year 2016 for which adequate attention had not been paid appear below.

- (a) The Company has registered as a primary dealer with the Central Bank of Sri Lanka in 2003. According to Section 2.1 of the Agreement entered into between the Mahapola Trust Fund and National Wealth Corporation, all the investment decisions should have been taken by the Investment Committee appointed by the Trust. However, in contrary this requirement then CEO and Chief Dealer of the Company had involved in taking an investment decision on performing the repurchase transactions with two private companies namely Trillion Securities (Pvt) Ltd. and Virtual Investment & Trading Lanka (Pvt) Ltd. Further, no approval in this connection had been obtained. Subsequently, the Company had conducted a forensic audit in this regard and according to the forensic audit report, it was revealed that the above officers were involved in an irregular transaction.

The following observations are also made in this connection.

- (i) It was observed that no action had been taken by the Company against the parties concerned even up to the date of audit on 23 May 2018.
- (ii) The Central Bank of Sri Lanka (CBSL) had issued a directive on 07 August 2015 to the Company by 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.
- (iii) 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 18 April 2016 by challenging the judgment delivered by the Court of Appeal. But no judgment had been delivered in favour of the Company by the Supreme Court. Nevertheless, the Company had submitted the Forensic Audit Report to the CBSL on 27 December 2016. However, the CBSL had not given any directive to the Company in this regard even up to the date of this report.
- (b) **Unauthorized Brokerage Payments**
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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 private 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. Further, the Company had failed to disclose this transaction in the financial statements prepared for the year 2016.