

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 2018 comprising the Statement of Financial Position as at 31 December 2018 and the Statement of Financial Performance, Statement of Changes in Reserves 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 2018, 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 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 Bank;
- 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 for the year ended 31 December 2018 had resulted in a deficit of Rs.442,506,214 before taking into account the transfers from the Cess Fund towards net operational expenditure and it was reported the deficit of Rs. 391,794,823 for the preceding year. The main reasons of increasing deficit by Rs. 51 million or 13 per cent as compared with preceding year were increasing personnel costs by Rs. 35 million due to revision of emoluments of staff and increasing capital market development expenditure by Rs. 13 million.

2.2 Trend Analysis of major Income and Expenditure items

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

	2018 Rs.	2017 Rs.	Difference as a percentage
<u>Income of the Cess Fund and Compensation Fund</u>			
Cess Received	250,704,350	264,026,238	(5)
Interest on Investment under Cess Fund	264,406,422	245,603,792	7.6
Interest on Investment under Compensation Fund	39,829,392	36,329,850	9.6
<u>Expenditure of Commission</u>			
Staff Salaries	130,974,645	108,259,916	21.0
EPF & ETF	19,964,301	16,636,256	20.0
Staff Gratuity	13,045,173	3,490,950	273.7
Special Payment	15,882,863	11,504,623	38.1
Reimbursement of Fuel	416,120	2,648,779	(84.3)

Staff Vehicle Allowance	19,735,833	6,403,984	208.2
Capital Market Development Expenses - Total	85,159,152	72,065,352	18.2
• Capital Market and Product Development	48,933,373	46,675,368	4.8
• Public Awareness Programmes	20,632,925	11,432,025	80.5
• Educational Programmes	3,636,294	3,473,587	4.7
• International Membership Fees - IOSCO	3,529,660	2,908,967	21.3
• Publicity and Advertising	233,800	84,843	175.6
• Market Surveillance Cost	8,167,459	7,476,822	9.2
• Investigation and Inspection Expenses	25,641	13,740	86.6

- a. The Members of the Commission had approved a salary increase of 50 per cent from the basic point of the salary scale of each category of staff with effect from 01 March 2018 at its 404th meeting held on 22 January 2018. Accordingly, staff salaries, EPF and ETF and special payment (one month basic salary twice the year) had been increased during the year under review.
- b. The Members of the Commission had revised the vehicle allowance for the positions of Assistant Director and upwards and extended same to the Manager, Senior Assistant Manager, Assistant Manager, Officers, Senior Executive Secretary and Executive Secretary with effect from 01 March 2018 and abolished the reimbursement of fuel paid to Managers upwards at its 404th meeting held on 22 January 2018. Accordingly, when reimbursement of fuel to manager upwards had decreased by 84 per cent, Staff Vehicle allowance had increased by 208 per cent during the year under review as compared with the preceding year.
- c. Gratuity liability was calculated by a qualified actuary as at 31 December 2018 using the Projected Unit Credit method as recommended by Sri Lanka Public Sector Accounting standard 19, “Employee Benefit” for the first time. Therefore, Staff Gratuity had increased during the under review.
- d. Capital Market and Product Development expenditure for the year under review was Rs. 48.9 million. It was mainly included an amount of Rs.26.8 million or 54.8 per cent

spent for Broker Back Office systems (BBO) and Order Management System (OMS). Further, an amount of Rs. 15.7 million or 32.1 per cent was incurred for Investor Forum held at New York, New Zealand, Australia, Singapore and United Kingdom in 2017 and 2018.

- e. As per the Section 14B (2) a of the Securities and Exchange Commission Act No. 36 of 1987, it is authorized to carry out capital market development activities. Accordingly, 18 per cent of the total expenditure had been spent in the year under review for the capital market development activities as compared with 17 per cent in the preceding year.

3. Operating Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
a There were 91 entities under the supervision of the Supervision Division as at 31 December 2018. The Division had scheduled to conduct on-site inspections relating to 49 entities during the year under review and completed on-site inspections relating to 28 entities excluding 5 special on-site inspections conducted during the year under review.	The Supervision Division adopts a Risked Based Approach in Conducting on-site inspections. The entities with the high risk were focused in conducting the on-site inspections in 2018.	Need to conduct inspections as Scheduled.
b Out of 33 cases handled by the Investigations Division during the year under review, investigations of ten cases had been completed as at 22 August 2019 and reports of the 4 completed investigations to be submitted to the members of the Commission. The investigations of 23 other cases which were registered from July 2013 to	Agreed	Give priority to complete the all outstanding investigations.

February 2018 are in progress.

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| <p>c Implementation of Delivery Versus Payment (DvP) in sequentially implementing the Central Counter Party Mechanism (CCP) was planned to complete at the end of first quarter 2018 and it was extended to first quarter 2019. However, implementation of the DvP settlement model is in progress as at 22 August 2019.</p> | <p>The Colombo Stock Exchange has informed that the system changes and the infrastructure updates required for this DvP implementation will be completed by the end of 2019 and six months after that to complete the implementation.</p> | <p>Complete the DvP implementation as schedule and initiate discussions with the Central Bank of Sri Lanka to implement an integrated CCP.</p> |
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3.2 Human Resources (HR) Management

Audit Issue	Management Comment	Recommendation
<p>a In terms of Section 43 (2) of the Security and Exchange Commission Act No. 36 of 1987, the officers and servants appointed shall be remunerated in such manner and at such rates and shall be subject to such conditions of service as may be determined by the Members of Commission. Further, according to the letter dated 31 March 1992 of the Secretary to the Ministry of Finance and Planning, the Commission is privileged to recruit its staff and fix their salaries and other emoluments without considering other Government regulations.</p> <p>Accordingly, salary scale of the staff and other emoluments such as special living</p>	<p>In order to effectively discharge the mandate of the Commission, appropriately qualified and experienced staff of stature must be recruited and retained. Section 43 of the SEC Act provides that the Members of Commission may appoint officers and servants and they shall be remunerated in such manner and at such rates as may be determined by the Members of Commission."</p> <p>In March 1992, the then Secretary to the Ministry to</p>	<p>Seek the concurrence of the National Salaries and Cadre Commission with respect to the salaries and emoluments offered to its staff as per the recommendation of the Committee on Public Enterprises.</p>

allowance, monthly allowance, staff medical expenses, staff vehicle allowance and special payment were decided time to time by the Members of Commission. However, as per the recommendation at the meeting of the Committee on Public Enterprises (COPE) dated 18 September 2018, Commission should seek the concurrence of the National Salaries and Cadre Commission with respect to the salaries and emoluments offered to its staff. Such a concurrence had not been obtained by the Commission even up to 22 August 2019. Further, as per the Management Service Circular No.03/2018 dated 18 July 2018, relevant Authorities should refrain from recruiting employees and increasing the salaries and allowances of their employees without obtaining prior approval from the Department of Management Services, General Treasury.

- b Approved Cadre of the Commission as at 31 December 2017 was 96 and approval of the Department of Management Services for the above Cadre had been obtained. At the 404th Commission meeting held on 22 January 2018, the Members of the Commission endorsed the decisions of the Remuneration Committee of the Commission that “if the Commission is free to recruit

Finance conveyed to the Commission that the Commission could recruit personnel and fix salaries and emoluments without being subject to Government Regulations given the need to recruit and retain specialized trained staff.

Since the Department of Management Services did not respond to the initial request made during the year 2017, the member of the Commission had approved the revision of cadre based on SEC Act and the directive issued by the Secretary to the Treasury

personnel in terms of the directive issued dated 31 March 1992. by the Secretary to the Treasury dated 31 March 1992 that is evident that the Commission should decide the composition of the Commission Cadre and that the Commission should stop obtaining the approval of the line as practiced in the Past.” Accordingly, the Cadre of the Commission was increased from 96 to 137.

However, approval of the Department of Management Services for the increased Cadre of 41 had not been obtained as mentioned in the aforesaid circular No.03/2018 dated 18 July 2018.

- c It was observed that the post of Director Capital Market Development, Director Investigations, Director Human Resources and Director Capital Market Education and Training under the approved Cadre as at 31 December 2017 were vacant as at 22 August 2019. The vacant posts were advertised in several times. Suitable candidates were not identified. Give priority to fill the necessary posts such as Director Investigations.
- d 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 Steps will be taken to follow up regarding the refund of half salary paid to him. Make arrangements to recover total paid salary as per the recommendation of the Committee on Public Enterprises.

Commission on behalf of him from 20 April 2016 to 31 August 2018 was Rs.5,212,815. As per the recommendation at the meeting 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 up to 22 August 2019.

4. Accountability and Good Governance

4.1 Budgetary Control

Audit Issue	Management Comment	Recommendation
Significant variances ranging from 37 per cent to 96 per cent were observed between 15 budgeted and actual expenditure items thus, indicating that the budget had not been made use of as an effective instrument of management control.	Total value of 12 expenditure items out of the 15 items is amounting to Rs. 9.4 Mn. (budget) and Rs. 4.1 Mn (actual) as the quantum of such expenses are very low though percentage variances were material.	Need to use the Budget as an effective instrument of management control.