

## **National Wealth Corporation Limited – 2018**

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### **1.1 Opinion**

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The audit of the financial statements of the National Wealth Corporation Limited (“Company”) and its subsidiary for the year ended 31 December 2018 comprising the statement of financial position as at 31 December 2018 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 2018, 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 01 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 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.

### **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**

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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| Description of unauthorized transaction  | Comments of the Management   | Recommendation  |
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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.Eventhough 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 honour 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. |
| (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 transations 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 Registred Stock and Securities (Primary Dealer) Regulations No. 01 of 2009 dated 24 June 2009. Since the | 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 | It is recommended that to get an urgent decision from CBSL about this matter.   |

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, the CBSL had not given any directive to the Company in this regard even up to the date of this report.

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.

- (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.

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| Reference to Laws, Rules Regulations etc.                                | Non-compliance  | Comments of the Management  | Recommendation                              |
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| Section 9.1 of the Public Enterprises Circular No PED 12 of 02 June 2003 | The Company should have a cadre with appropriate skills to maximize productivity of its employees. However ,the company does not have a cadre for the year 2018 | The board of directors of NWCL, at its meeting held on 14 <sup>th</sup> December 2018, has approved the cadre of the organization. We have submitted the approved organization cadre together with exact of the minutes of the Board meeting for the approval of the board of trustee of MHESTF on 28 <sup>th</sup> February,2019.Same will be implemented after the approval of the Trust Board. | Company need to comply with this regulation |

## 1.7 Non -compliance with Tax Regulations

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| Audit observations  | Comments of the Management   | Recommendation   |
|---|--|--|
| (a) The Company has 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 Rs.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 per cent penalty | 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 | 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. |

on the above assessments.

income. Therefore, income tax assessments issued were disregarded due to the specific provision.

(b) The Company has 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 Rs.58,097,943 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 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 company and its subsidiary during the year under review amounted to a loss of Rs.242,447,325 and the corresponding profit in the preceding year amounted to Rs. 160,580,556. Therefore a deterioration amounting to Rs. 403,027,881 of the financial result was observed. The reasons for the deterioration are decrease in Investment and other operating income by Rs.101,168,574 and capital gain from revaluation in dealing securities by Rs. 304,253,674

### **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 is given below.

- a) Company and its subsidiary Investment and other operating loss of Rs.28,232 for the year 2018 in comparison to the preceding year Investment and other operating income of Rs.101,140,342, thus showing a deterioration of 100 percentage in Investment and other operating income of the company and its subsidiary.
- b) Loss from revaluation of dealing securities of Rs 165,049,270 for the year 2018 as compared with the preceding year of profit from revaluation of dealing securities of Rs.139,204,404, thus showing a decrease of 219 percentage in the revaluation of dealing securities.

### 3. Operational Review

#### 3.1 Identified Losses

| <b>Audit Issue</b>  | <b>Comments of the Management</b>  | <b>Recommendation</b>   |
|---|--|---|
| The director board of the company has given the approval to dispose the equity portfolio by their Decision No. NWCL/BM 164/BP 07 on 29 <sup>th</sup> March 2018. As a result the NWCL has incurred a capital loss of Rs.4, 049,264 and capital gain of Rs.29, 778 where there is net capital loss of Rs.4, 019,486.00. However, the reason for this decision was not available for audit. | The Board Risk & Investment committee at its meeting held on 15 <sup>th</sup> February 2108 considered the paper No NWCL/2018/02/02 and unanimously agreed to dispose company's entire equity portfolio and instructed senior management to ensure the minimal loss to the company with gradual step by step disposal with minimal capital loss. | The company should develop suitable strategies to ensure that adequate profitability is achieved. |

#### 3.2 Operational Inefficiencies

| <b>Audit Observations</b>   | <b>Comments of the Management</b>   | <b>Recommendation</b>   |
|---|---|---|
| The fund management fee was calculated based on the unaudited net asset of the Mahapola Higher Education Scholarship Trust Fund | Company's Internal Auditors check the Management fees calculation and Mahapola trust fund accounts on a monthly basis and report to the company's Audit Committee | Internal Audit reports should be submitted to the Government Audit. |

#### 3.3 Procurement Management

| <b>Audit Observations</b>   | <b>Comments of the Management</b>   | <b>Recommendation</b>                        |
|---|---|--|
| Although the company has prepared a capital budget for 2018, company has not followed the procurement guidelines for the procurement made during the year 2018. | The board formed a procurement and Technical committee as per procurement guideline and forwarded to the Mahapola Committee to obtain approval. And Ensure that the company will follow all relevant sections under the procurement guideline including preparation of three years master procurement plan. | Company need to comply with this regulation. |

#### 4. Accountability and Good Governance

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##### 4.1 Corporate Plan

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| Audit Observations   | Comments of the Management   | Recommendation  |
|--|--|---|
| <p>According to the strategic business plan 2018-2020, the budgeted Net profit before tax is Rs.230 Mn for the period of 2018. But the company actual Net loss before tax was Rs.242 Mn That was a difference of Rs.472 Mn between actual and estimated profit before tax. It showed that the company had not achieved the target based on the strategic business plan in 2018</p> | <p>We anticipated to sell equity portfolio of NWCL worth of Rs.13.9 Mn in the secondary market and invest sale proceeds in high yielding instrument at around 11 percentage p.a. However due to the adverse market conditions we were unable to dispose shares immediately in the stock market. Equities were disposed in different intervals of the year and the company has incurred a capital loss of Rs.4.4 Mn from equity sales. Due to delay in investing funds we were unable to achieve the expected operating income. Incurring of capital loss from equity portfolio and delay in investment have mainly contributed towards the non-achievement of the budgeted investment.</p> | <p>The company should develop suitable strategies to achieve the target based on the strategic business plan.</p> |