

## **Natwealth Securities Limited – 2018**

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### **Opinion**

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The audit of the financial statements of the Natwealth Securities Limited (“Company”) 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 reported 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.

### **1.1 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.

### **1.2 Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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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.

### **1.3 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.

## 1.4 Financial Statements

### 1.4.1 Unauthorized Transactions

Description of unauthorized transaction	Comments of the Management	Recommendation
(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	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	It is recommended that to get an urgent decision from CBSL about this matter.

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.

- (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 18 April 2016 by challenging the judgement 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.

- (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

an opportunity to be heard before any such action is taken. The professional legal opinion 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

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.

companies had registered at the CBSL as financial companies before making the payment.

#### 1.4.2 Documentary Evidences not made available for Audit

Item	Amount	Evidence not available	Comments of the Management	Recommendation
	Rs.			
Debenture	19,152,440	Balance Confirmation	These non confirm Total balances are made from individual clients. So they did not confirm.	It is recommended that if the existing balance is material. Management responsible for getting confirmation.
Reverse Repo	77,776,731.			

#### 1.5 Non-compliance with Laws, Rules, Regulations and Management Decisions etc.

Reference to Laws, Rules Regulations etc.	Non-compliance	Comments of the Management	Recommendation
Public Enterprises Circular No PED 12 of 02 June 2003,Section 9.1	Company should have a cadre with appropriate skills to maximize productivity of its employees. However NWSL does not have a cadre for the year 2018. Therefore the salary scale and the promotion procedures are not clearly mentioned.	The board of directors of NWSL, 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

## 1.6 Non -compliance with Tax Regulations

Audit Issue	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 on the above assessments.	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 income. Therefore, income tax assessments issued were disregarded due to the specific provision.	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.
(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

### 2.1 Financial Result

The operating result of the year under review amounted to loss of Rs.243, 412,073 and the corresponding profit in the preceding year amounted to Rs.163, 361,554. Therefore a deterioration amounting to Rs 406,773,627 of the financial result was observed. The reasons for the deterioration are decrease in investment income by Rs. 64,201,517 and loss from revaluation of dealing securities by Rs.308,806,133.

## 2.2 Trend Analysis of major Income and Expenditure items

Major income and expenditure items of the year under review compared with the preceding year is given below.

- a) Investment income of Rs.403,341,709 for the year 2018 in comparison to the preceding year Investment income of Rs.467,543,226, thus showing a decrease of 14 per cent in investment income of the company.
- b) Loss from revaluation of dealing securities of Rs 167,757,635 for the year 2018 as compared with the preceding year of Gain from revaluation of dealing securities of Rs 141,048,498, thus showing a decrease of 219 per cent in Loss from revaluation of dealing securities.
- c) Other income of Rs.11,400 for the year 2018 in comparison to the preceding year other income of Rs.45,450, thus showing a decrease of 75 per cent in other income of the company.

## 3. Operational Review

### 3.1 Operational Inefficiencies

#### Audit Observations

The operating results of the year under review amounted to a loss of Rs. 243,412,073.

#### Comments of the Management

Interest rates of Govt.Securities were under continuous pressure due to increase in the Govt Debt. Repayments which were amounted to Rs.2,100 Bn for the year 2018.Interest rate went up in March 2018 due to selling of government securities by foreign investors. With the assistance of marketing team company were able to increase the Govt securities portfolio to Rs.8.35 Bn by 31<sup>st</sup> August 2018.But we were unable to achieve.

#### Recommendation

The company should develop suitable strategies to ensure that adequate profitability is achieved.

### 3.2 Procurement Management

#### Audit Observations

Company had not been complied with the Government procurement guidelines.

#### Comments of the Management

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.

#### Recommendation

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

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According to the strategic business plan 2018-2020, the budgeted Net profit before tax is Rs. 227 Mn for the year 2018. But the company actual Net loss before tax was Rs. 243 Mn which is 207 per cent of difference had obtained from budgeted and actual net profit before tax. It showed that the company had not achieved the target based on the strategic business plan in 2018.

###### Comments of the Management

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Interest rates of Govt. Securities were under continuous pressure due to increase in the Govt Debt. Repayments which were amounted to Rs 2,100 Bn for the year 2018. Interest rate went up in March 2018 due to selling of government securities by foreign investors. We anticipated increasing leverage portfolio to Rs.8.5 Bn by 31<sup>st</sup> August 2018 with the interest margin of 1.2 per cent p.a. With the assistance of marketing team we were able to increase the Govt securities portfolio to Rs 8.35 Bn by 31<sup>st</sup> August 2018. However we were unable to achieve the budgeted margin due to the high borrowing cost.

###### Recommendation

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The company should develop suitable strategies to achieve the target based on the strategic business plan.