

## **Securities and Exchange Commission of Sri Lanka – 2014**

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The audit of financial statements of the Securities and Exchange Commission of Sri Lanka (SEC) for the year ended 31 December 2014 comprising the statement of financial position as at 31 December 2014 and the statement of financial performance, statement of changes in reserves and cash flow statement 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 read in conjunction with Section 13(1) of the Finance Act, No. 38 of 1971 and Section 37(2) of the Securities and Exchange Commission of Sri Lanka Act, No.36 of 1987.

### **1.2 Management’s Responsibility for the Financial Statements**

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Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Sri Lanka Public Sector Accounting Standards and for such internal control as the management 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**

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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 consistent with International Standards of Supreme Audit Institutions (ISSAI 1000-1810). 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 judgement, 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 SEC’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 SEC's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act , No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

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

## **2. Financial Statements**

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### **2.1 Opinion**

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In my opinion, the financial statements give a true and fair view of the financial position of the Securities and Exchange Commission of Sri Lanka as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

### **2.2 Non - compliance with Laws, Rules, Regulations and Management Decisions**

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The SEC had paid an annual bonus of Rs. 11,437,446 for the year under review contrary to the instruction given by the Public Enterprises Circular No.DMS/CIR/2014/Bonus of 21 November 2014 and the paragraph 13 of COPE Minutes dated 17 September 2010.

**3. Financial Review**

**3.1 Financial Results**

According to the financial statements presented, the operations of the SEC for the year ended 31 December 2014 had resulted in a net deficit of Rs.348,004,718 before taking into account the transfers from the Cess Fund for the operational expenses as compared with the corresponding net deficit of Rs. 305,703,501 for the preceding year. The net deficit for the year under review after taking into account the transfers from the Cess Fund for the year amounted to Rs.14,326,491 as against with the net surplus of Rs. 12,843,540 in the preceding year after taking into account the transfers from the Cess Fund for that year, thus indicating a decrease of Rs.27,170,031 in the net surplus.

**3.2 Analytical Financial Review**

The revenue of the SEC for the year under review was Rs. 364 million including transfers from the Cess Fund to meet operational expenses amounting to Rs.334 million as compared with Rs.348 million, including transfers from the Cess Fund amounting to Rs. 319 million, in the preceding year representing an increase of 4.6 per cent in the total income and whereas the expenditure incurred for the capital market development activities during the year under review was Rs. 104 million when compared with Rs. 66 million of the previous year thus indicating an increase of 58 per cent. The changes of the revenue and expenditure of the SEC during the year under review, as compared with the preceding year are shown below.

	<b>2014</b>	<b>2013</b>	<b>Change</b>	
	Rs.(M)	Rs.(M)	Rs.(M)	%
Transfer from Cess Fund	334	319	15	4.7
Broker License fees, administration levy and educational programmes	12	14	(2)	(14.2)
Sundry income and recognition of grant	18	15	03	20
Personal and administration cost	274	269	5	1.86
Capital market development expenses	103	66	37	56.0
Surplus/(Deficit) for the year	(14)	13	27	208

It was observed that only 27 per cent of the total expenditure had been spent in the year under review as the capital market development as compared with that in the preceding year was only 20 per cent.

#### **4. Operating Review**

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##### **4.1 Performance**

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##### **4.1.1 Achievement of Targets in the Annual Action Plan**

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Significant delays had been observed in audit with regard to the achievement of targets stipulated in the Corporate Plan and in the Action Plan for 2014-2016 which had been revised during the year under review. Details are given below.

<b>Division</b>	<b>Objectives and Strategies</b>	<b>Scheduled date of commencement</b>	<b>Scheduled date of completion</b>	<b>Delay in months as at 31December 2014</b>	<b>Revised date of completion</b>
Capital Market Development and Research	Attracting new funds (foreign & local) to broad base the market				
	<ul style="list-style-type: none"> <li>● <b>Facilitate establishment of a commodities and derivatives exchange</b></li> </ul>				
	*Facilitate streamlining the process of entry to the Sri Lankan Capital Market by foreign investors with CSE	1Qtr. 2014	2Qtr. 2014	6	4Qtr. 2015
	*Evaluate setting up of benchmark for account opening procedure with CSE	1Qtr. 2014	2Qtr. 2014	6	4Qtr. 2015
	<ul style="list-style-type: none"> <li>● <b>Attracting new funds (foreign &amp; local) to broad base the market</b></li> </ul>				
	*Enabling Real Estate Investment Trust (REITs)	1Qtr. 2014	4Qtr. 2014	6	2Qtr. 2016
	*Enabling Exchange Traded Funds (ETFs)	1Qtr. 2014	4Qtr. 2015	0	2 Qtr. 2016
Investigation	<ul style="list-style-type: none"> <li>● Improvement of the investigations infrastructure and methodology</li> </ul>	1Qtr. 2009 (CP 2009)	2Qtr. 2011	42	2Qtr. 2015
	<ul style="list-style-type: none"> <li>● Improve the data base on investigations carried out using IT inputs</li> </ul>	4Qtr. 2010 (CP 2011)	2Qtr. 2011	42	3Qtr. 2015
Supervision	<ul style="list-style-type: none"> <li>● Facilitate to develop the Broker Back Office systems (BBO) to maintain minimum requirements to be in compliance with Risk based Management System (RMS) , Delivery Vs. Payment (DvP) and Central Counter Party (CCP) for Stock Broking Companies</li> </ul>	4Qtr. 2012 (CP 2013)	2Qtr. 2014	6	4Qtr. 2015
Finance and Administration	<ul style="list-style-type: none"> <li>● Identify suitable permanent office premises</li> </ul>	1 Qtr. 2012	3Qtr. 2012	27	4 Qtr. 2014

#### **4.1.2 Surveillance and Investigations**

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According to the Securities and Exchange Commission of Sri Lanka Act, actions should be taken in timely manner against the detections in order to minimize the violations such as price manipulation, insider/related party dealings, unethical conduct by brokers etc. However, out of the 18 referrals identified by the SEC during the year under review through the Surveillance Division and the Colombo Stock Exchange, only 03 referrals were warranted for further investigations by the Investigation Committee.

Out of the 05 investigations conducted by the Investigation Division, 01 investigation was concluded and the matter was referred to the Attorney General, 01 report of the investigation was referred to Investigation Committee and they are deliberating the content of the report yet. Balance 03 investigations are in progress.

#### **4.2 Matters of Contentious Nature**

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The following observations are made.

- (a) Out of the total expenditure on public awareness programmes of Rs. 53.7 million, Rs. 3.0 million on Deyata Kirula and Rs.2.5 million on advertisement charges of the 9<sup>th</sup> anniversary accession of the President had been incurred by the SEC. The Chairman had informed me that on 29 May 2015, the SEC had participated in the above programmes to highlight the capital market performance.
- (b) The expenses incurred by the SEC on Capital Market Development for the year under review amounted to Rs.36.1 million compared with the corresponding expenditure of Rs. 15.9 million in the previous year had increased by Rs. 20.1 million. Out of the above Rs. 36.1 million, Rs. 24.7 million or 68 per cent had been spent for conducting 03 road shows in Hong Kong, New York and United Kingdom. The Chairman informed me on 29 May 2015 that the SEC had conducted

the above road shows and incurred sums highlight the capital market performance and 50 per cent of the total cost had been incurred by the Colombo Stock Exchange.

- (c) The bill of a credit card which was issued to the Chairman of the SEC amounting to Rs.169,871 had been incurred out of SEC Funds during the year 2014. However, the Treasury approval had not been obtained to issue a credit card to the Chairman.

### **4.3 Human Resources (HR) Management**

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The following observations are made.

- (a) The SEC had recruited an Executive Secretary in 2012 on contract basis with the approval of the Ministry. According to the approval of the SEC and the Ministry, the contract period was only up to the period of former Chairman. It is observed in audit that she had worked at the Commission for 3 months after the leaving of the former Chairman without getting approval of the Ministry and had been paid Rs. 318,607 as remuneration by the SEC.
- (b) The SEC had recruited an Executive Secretary, a driver and an office aide without following the recruitment procedure of the Commission's Administration Manual.
- (c) Even though the approved cadre of the SEC was 96, the actual number of employees of the SEC made under 08 service categories, were 80 up to the end of the year under review and the vacancies had not been filled even up to the end of April 2014.
- (d) As per the paragraph No.12:5:4 of the Establishments Code, the SEC had appointed one permanent officer to act in another post and paid acting allowance of Rs. 450,000 for the year under review without obtaining the approval from Secretary to the Treasury and Secretary to the Ministry of Public Administration. According to the Public Administration Circular No. 06/97 of 03 February 1997, the period of acting appointment should be maximum of 03 months, and the vacancy for the acting post had not been filled at the end of the year under review.

**5. Budgetary Control**

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Significant variances were observed between the budgeted and actual income and expenditure thus indicating that the budget had not been made use of as an effective instrument of management control.

**6. Systems and Controls**

Special attention is needed in respect of the following areas of control.

- a) Human Resource Management.
- b) Internal control.