

Insurance Regulatory Commission of Sri Lanka – 2017

The audit of financial statements of the Insurance Regulatory Commission of Sri Lanka for the year ended 31 December 2017 comprising the statement of financial position as at 31 December 2017 and statement of financial performance 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 8(3) of the Regulation of Sri Lanka Insurance Industry Act, No. 43 of 2000 as amended by Regulation of Insurance Industry (Amendment) Act No.23 of 2017. My comments and observations which I consider should be published with the Annual Report of the Commission in terms of Section 14(2)(c) of the Finance Act appear in this report. A detailed Report in terms of Section 13(7)(a) of the Finance Act, was issued to the Chairman of the Commission on 18 July 2018.

1.2 Management’s Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with 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

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 Auditing 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 misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Commission’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 Commission’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 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.

1.4 Change of the name of Insurance Board of Sri Lanka (IBSL) as the Insurance Regulatory Commission of Sri Lanka

With the objective of exempting from being listed on a stock exchange licensed under the provisions of the Securities and Exchange Commission of Sri Lanka Act of all insurance companies registered under the Insurance Board of Sri Lanka, the name of Insurance Board of Sri Lanka had been changed as the Insurance Regulatory Commission of Sri Lanka by the Regulation of Insurance Industry (Amendment) Act No.23 of 2017.

1.5 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the Insurance Regulatory Commission of Sri Lanka as at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Public Sector Accounting Standards.

2.2 Comments on Financial Statements

2.2.1 Sri Lanka Public Sector Accounting Standards

The following observations are made.

(a) Sri Lanka Public Sector Accounting Standard – 7

Motor vehicles purchased in the years 2006, 2008 and 2012, the carrying amount of which amounted to Rs.2,604,348 had been revalued for Rs.10,000,000 in the year 2014. In terms of paragraph 47 of the standard, when the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. However, a revaluation had not been carried out after the year 2014.

(b) As the residual value and the useful life of non-current assets had not been reviewed at least at each annual reporting date, assets costing Rs.31,724,786 except motor vehicles had been fully depreciated, though they had been further used, in terms of paragraph 65 of the standard. Accordingly, action had not been taken to rectify the estimated error.

2.2.2 Accounting Policies

The following observations are made.

- (a) In applying for the registration as an insurance institution, a specific period of time to fulfill the requirements thereof had not been determined. According to the conditions stated in the application, when the institute which had submitted applications for the registration as an insurance institution had withdrawn that application, it was stated that only 50 per cent of the relevant amount would be refunded. However, without doing so, it was observed in 3 occasions subjected to audit examination that in one instance, the total sum of Rs.500,000 spent had been refunded, an instance where the total amount paid had been retained and accounted as payable amount and one instance where the entire amount had been taken to revenue.
- (b) The policy in respect of library books adopted by the Commission was that the cost of all books had been brought to accounts as the expenditure of the year of purchase. However, it was observed that the books costing over Rs.100,000 purchased by the Commission had been brought to accounts as expenditure as stated above according to the library accession register.

2.2.3 Accounting Deficiencies

According to the section 61(1) and (2) of the Regularization of Insurance Industry Act No.43 of 2000, every insurer should pay annual fee on the total recorded premium of its insurance companies to the Insurance Regulatory Commission of Sri Lanka. Accordingly, a sum of Rs.1,460,687 receivable from an insurance company which suspended its business on 28 June 2017, had not been brought to accounts.

2.2.4 Unexplained differences

Even though, a sum of Rs.10,062,587 had been shown in the financial statements of the Commission as cess income receivable from the National Insurance Trust Fund for the year 2017, according to the financial statements of the National Insurance Trust Fund for the year 2017 the cess income payable to the Commission amounted to Rs.16,107,274 and as such a difference of Rs.6,044,687 had been observed.

2.3 Accounts Receivable

A sum of Rs.500,000 received from an Insurance Company in the year 2015 which applied for the separation of insurance entities as long term (life insurance) and general insurance in terms of Section 38(1)(b) of the Regularization of Insurance Industry Act No.43 of 2000 and a tax amounting to Rs.71,429 receivable relating thereto had not been separated even by the time of audit as per the Act, and as such it had not been settled.

2.4 Non-compliance with Laws, Rules, Regulations and Management Decisions

The following non-compliances were observed.

Reference to Laws, Rules and Regulations	Non-compliance
(a) Section 38(1) (b) of the Regularization of Insurance Industry Act No.43 of 2000.	Even though, assets of the long term insurance (life insurance) business should be separately kept from the assets of another class of insurance business, 2 Insurance Companies out of 12 registered insurance companies had not done so up to now.
(b) Financial Regulation of the Democratic Socialist Republic of Sri Lanka Financial Regulation 371	Even though, a sub-imprest obtained should be settled immediately after the completion of the purpose for which it is granted, an advance of Rs.755,996 obtained had not been settled up to the date of audit though it had elapsed for more than 06 months.
(c) Paragraph 9.14 of Public Enterprises Circular No.PED/12 of 02 June 2003.	Even though, an Administrative manual should be prepared and to submit and obtain the sanction of the Secretary to the Treasury with the approval of the Board of Directors, the sanction of the Secretary to the Treasury had not been obtained for the manual even by the date of audit.

3. Financial Review

3.1 Financial Results

After tax surplus or a deficit had not been indicated in the financial statements of the Commission since the inception of the Commission. The Commission had negated the above mentioned surplus or deficit by adjusting the expenditure over revenue against the Insurance Policy owners Security Fund. According to the financial statements presented, the income of the Commission had increased by Rs.20,622,656 as compared with that of the previous year and the total expenditure of the Commission had also increased by Rs.20,457,782, representing 15 per cent. Increase of transfer of funds to the Insurance Policy holders Security Fund by Rs.19,035,468 and increase of operating expenses by Rs.4,179,824 had mainly attributed to increase the expenditure.

Although, an operating surplus had not been reported during the 5 years from 2013 to 2017 of the Commission according to the financial statements, the contribution of the Commission had gradually increased in the years 2013, 2014, 2015 and 2016 in the examination of overall contribution variances during the past 5 years. The contribution of the year under review had also increased but it had been only 19 per cent as compared with the previous year. The main reasons therefor was the transfer of funds to insurance policy holders fund during the year under review.

4. Operating Review

4.1 Performance

4.1.1 Operations and Review

According to the annual action plan, the following observations are made in respect of the progress of the Investigations, Supervisions, Legal and Market Development and External Relationship divisions.

(a) Investigation Division

- (i) According to the guideline letter dated 01 October 2016 issued in respect of the procedure to be followed in the settlement of consumers complaints by the insurers and insurance agents, the insurance companies should sent information within 30 days to the Commission half yearly from 01 January 2017 in the specimen form introduced in respect of complaints, such information had not been sent by 09 insurance companies out of 27 up to the date of audit.
- (ii) Out of 348 complaints received in the year 2017, 57 complaints or about 16 per cent had remained unresolved even by 24 July 2018, the date of audit.

(b) Supervision Division

- (i) In terms of Section 38(3)(a) of the Regulation of Insurance Industry Act No.43 of 2000, each insurer can be requested to provide a periodical report from time to time in a specific form determined. Their monthly statutory reports so requested should be submitted to the Commission within 21 days after the end of the month. Even though, 3 insurance companies had not submitted such report so requested within the specific period to the Commission, action had not been taken by the Commission in that regard.
- (ii) According to the Action Plan the Insurance Industry Manual for the year 2016 had been planned to be published within the 3rd and 4th quarters of the year 2017. However, it had been published in April 2018 after a delay of over 4 months.

- (iii) As the post of Actuary had fallen vacant since 31 October 2017, liabilities in accordance with risk based capital framework of the Insurance Companies had not been reviewed from the 3rd and 4th quarters of the year 2017 to date.
- (iv) In terms of Section 48 (1) of the Regularization of Insurance Industry Act No.43 of 2000 the actuarial information presented by insurers should be reviewed and recommended but the actuarial reports submitted by insurers had not been reviewed up to now since 2016 as the post of actuary had fallen vacant.
- (v) Sixty Insurance brokers' companies had been registered under the Sri Lanka Insurance Regulatory Commission. Of these companies, field inspection supervision had been carried out only in 8 companies during the year 2017, representing about 13 per cent of the total number of brokers' companies.

(c) **Legal Division**

- (i) Registration of brokers, defined in Section 114 of the Regularization of Insurance Industry Act No.43 of 2000 had been temporary suspended with effect from 27 April 2012 and that prohibition had been removed on 02 May 2016 and the registration of new insurance brokers had been commenced. However, it was observed that there were long delays in the registration activities as the commission had not introduced a specific methodology or procedure for the registration of brokers companies.
- (ii) The commission had informed all insurance companies and 60 insurance brokers' entities by its Direction No. 9 dated 13 March 2016 that every insurance and insurance brokers entity should appoint the Chief Executive Officer or Executive Manager or a responsible officer as the principal officer in order to execute monitoring /advisory functions and informed the Commission before 12 May 2017. Even though, this period had been extended up to 30 September 2017 on the requests made by those companies, two insurance entities had not appointed a principal officer even up to 24 July 2018, the date of audit.
- (iii) The Commission had suspended the business of Ceylinco Thakaful Ltd. in the year 2009. According to the decision delivered by the Supreme Court at the Fundamental Rights Case No.SC(FR)191/09, in order to settle genuine Insurance Claims systematically, made available to that company, a memorandum of understanding had been entered into with the company by the then Board to dispose of that company's assets. However, out of 142 genuine claims, 132 had been settled and the present position of 10 case files was not made available even up to 24 July 2018, the date of audit.

(d) Market Development and External Relations Division

- (i) Even though 10 awareness programs had been conducted in the District Secretariats targeted at Grama Niladharies of the Divisional Secretariats, Police, Divineguma, Development Agriculture and field officers including other public officers, it was observed in audit that such awareness programs had not been conducted being targeted at general public. Furthermore, 50 per cent of the programs had been conducted only in the Central Province.
- (ii) Comments on the contents and the successfulness of the awareness programs conducted in the District Secretariats had been obtained from the officers participated through a questionnaire. Accordingly, it was not observed in audit that the program had been updated and replies had been reviewed in accordance with the response, though it was stated that presenting the questionnaire had been useful for the improvement of the quality of future programs.
- (iii) It was planned to conduct 2 awareness programs to school children but only 01 program had been conducted during the year under review.
- (iv) According to the Action Plan, it was planned to publish the progress of insurance industry in Sri Lanka in the year 2016 in printed media in 3 languages in Sinhala, Tamil and English but it had been published only in English.
- (v) According to the action plan for the year 2017, it was planned to prepare replies to questions regularly asked via website of the Commission and to include in the website. However, it had not been so done even up to 18 May 2018.
- (vi) Even though 08 brochures and 03 handouts published in the website had been printed they had not been updated and new handouts whatsoever had not been published.
- (vii) Even though action had been taken to open a YouTube account as “Sri Lanka Insurance Board” for the awareness of insurance through social media, to link as electronic and printed media awareness in 2016 and to include in the website of Sri Lanka Insurance Regulatory Commission, the websites had not been updated after September 2016.
- (viii) A program proposed to be implemented for acquiring knowledge on the insurance policies in Sri Lanka in giving technical assistance by the Asian Development Bank and in that case, a gap analysis had been carried out and identified the weaknesses. Accordingly, the Education Strategies and implementation plan had been given to the Commission in October 2017 but a proposed program therefore commencement of program not observed even by 24 July 2018.

(e) **Finance and Administration Division**

According to the data of the budget for the year 2017, provisions of Rs.3,000,000 and Rs.10,000,000 had been made for the local and foreign training respectively on capacity building of the staff but it was observed that the actual expenditure incurred thereon had decreased to Rs.1,297,577 and Rs.4,741,449 respectively.

4.2 Management Functions

The following observations are made.

- (a) Property, Plant and Equipment classes of assets, carrying value of which amounted to Rs.7,324,758, included in the financial statements of the year 2017 had included 145 items which had been identified at the year end board of survey classified as redundant or damaged. According to the register of fixed assets and identified in audit as non-usable, the cost of those items totalled Rs.2,331,989. Action had not been taken to dispose of the stock which had been identified as non-usable or damaged.
- (b) In terms of Section 103(1) of the Regularization of Insurance Industry Act No.43 of 2000, a fund named as “Insurance Policy Holders Security Fund” had been established with the objective of settling insurance claims of bankrupt insurance companies and the money accrued from cess has to be credited to this Fund. This fund was a long term fund and the balance thereof as at 31 December 2017 amounted to Rs.4,109,959,205 but there had been no opportunities arisen to spent money from this fund since the inception of the Fund. As such, the money of this fund could have been invested to earn a higher interest income but it had been invested for a few number of days, based on liquidity. Therefore, it was observed that the fund had been deprived of getting a higher interest income which could have been earned. Nevertheless, the Commission had informed the audit that, as the receipt of annual fees had been delayed, money of the fund had to be used to settle day today expenses, money had been invested in short terms.
- (c) In terms of internal circular No.36 of 05 October 2015, any person is permitted to operate a foreign health insurance through a brokers’ company and the related brokers’ company should be registered therefor. Under this method, the approval had been granted initially to two insurance companies for a period of one year but such approval had not been granted in writing and the extension of the approved period had been stated only in the website. The Commission had informed the audit that the extension of period stated in the website had been done without a proper authority and an investigation in that connection was being carried out.
- (d) The Commission had paid festival advances at Rs.50,000 in the months of April and December to its officers with effect from 2009 but the Commission had not taken a special approval thereon.
- (e) At the physical verification of Library books observed that 11 books lent outside had not been returned within the periods ranging from 01 to 07 years. Similarly, 2 books valued nearly Rs.100,000 were not physically existence within the Library.

4.3 Uneconomic Transactions

A building had been taken on rent for the operation of the Head Office of the Commission at a monthly rental of Rs.330,096 since 01 April 2005. Attention of the Board of Directors was paid in 2 occasions to find a new building due to increase the rent, since the period of rent agreement had been terminated as at 31 March 2008. However, it had not been implemented and an agreement had been entered again into with the owner of the same building for the period from 01 April 2008 to 31 July 2010 at the monthly rental payment of Rs.1,472,208.

4.4 Personnel Administration

The following observations are made.

- (a) Four vacant posts as at 31 December 2017 had been vacant even by the date of audit.
- (b) The scheme of recruitments relating to the approved posts of the Commission had not got approved in terms of paragraph 9.3.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003.
- (c) Even though, the Administrative manual prepared on 19 March 2012 had been submitted to the Ministry of Finance for approval on 30 March 2017, the approval had not been received up to now. However, all the functions such as recruitments, salaries and reimbursement of allowance and payment of advances had been carried out in accordance with the Administrative manual by the Commission.
- (d) The first salary scales of the Commission had been approved by the Department of Management Services in the year 2005 and differences between those salary scales and the actual scales paid now were observed. It was thus revealed that the National Salaries and Cadre Commission as well as the Line Ministry had informed that the salary increase could not be recommended. Despite, the salary scales had been increased on the basis of a Letter No.PED/360/12/2(ii) dated 18 July 2012 issued by the Treasury Representative of the Commission in the year 2012 stating that there was no objection to revise salaries subject to a maximum of 25 per cent of the basic salaries of officers.
- (e) As a result of being inclined for a Risk Based Capital Scrutinizing System (RBC) introduced in place of the Solvency Legal framework of insurance companies from the beginning of the year 2016, one Actuarial post, one Assistant Actuarial post and 2 Senior executive/ Executive posts had been approved for the establishment of the Actuarial unit on 09 June and 07 December 2016. A female officer had been recruited in the year 2016 for the post of actuary on contract basis, that post had fallen vacant since 31 October 2017 and the Assistant Actuary post had also been vacant from the year 2016 to 24 July 2018.

5. Sustainable Development

5.1 Reaching Sustainable Development objectives

Every public entity should act in accordance with the agenda of the United Nations 2030 on Sustainable Development but the insurance Regulatory Commission of Sri Lanka was not aware how to act in respect of functions come under the scope of the Commission relating to the year under review.

6. Accountability and Good Governance

6.1 Presentation of financial statements

Even though, the annual draft report and the financial statements should be presented to audit within 60 days after the closure of the financial year in terms of paragraph 6.5.1 of the Public Enterprises Circular No.PED/12 of 02 June 2003, the finally approved financial statements for the year under review had been presented to audit on 01 June 2018.

6.2 Procurement and Contract Process

6.2.1 Delayed Projects

An agreement had been entered into with the Central Engineering Consultancy Bureau on 11 May 2016 at a contract value of Rs.1,758,654 (excluding VAT) for the installation of coolant system to the computer systems operating room and an advance of Rs.50,000 had been paid on 07 June 2016. Even though, this work should have been completed by February 2018, it had not been completed even up to 06 August 2018, the date of audit.

6.3 Budgetary Control

As compared the budgeted income and expenditure of the Commission with actuals of the year under review, variations ranging from 100 per cent to 246 per cent were observed and as such the budget had not been made use of as an effective instrument of management control.

7. Systems and Controls

Weaknesses in systems and controls observed in audit were brought to the attention of the Chairman of the Commission from time to time. Special attention is needed in respect of the following areas of control.

Areas of Systems of control -----	Observations -----
(a) Operating control	Withdrawing money from the annual interest income of insurance policy holders preservation Fund, subject to a maximum of 20 per cent in order to cover up the expenditure of the Commission.
(b) Stock Control	<ul style="list-style-type: none"> (i) Stock not stored as to identify easily each item separately. (ii) Stock levels not indicated in the stationery stock books. (iii) Existence of slow moving stationery. (iv) Existence of differences between the physical verification of stationery stock and stock book balances.
(c) Financial Control	<ul style="list-style-type: none"> (i) Delays in settling imprests. (ii) Granting advances without being properly estimated. (iii) Registers not updated.
(d) Revenue Control	Revenue relating to the year under review not specifically identified.
(e) Assets Control	Incorrect identification code numbers.