

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 2019 comprising the Statement of Financial Position as at 31 December 2019 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 2019, 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 Audit Scope

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 Commission;
- 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 2019 had resulted in a deficit of Rs.375.4 million before taking into account the transfers from the Cess Fund towards net operational expenditure and it was reported the deficit of Rs. 442.5 million for the preceding year. The main reason for decreasing deficit by Rs. 67.1 million or 15 per cent as compared with preceding year was receiving a grant amounting to Rs. 81.1 million under Financial Sector Modernization Project.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income items of the Commission, 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.

	2019	2018	Difference
	Rs.	Rs.	as a percentage
<u>Income of the Cess Fund and Compensation Fund</u>			
Cess Received	223,020,518	250,704,350	11.04
Interest on Investment under Cess Fund	264,966,403	264,406,422	0.21
Interest on Investment under Compensation Fund	44,537,378	39,829,392	11.82
<u>Income of the Commission</u>			
Government Grant	81,124,254	-	100.0

Expenditure of Commission

Staff Salaries	128,380,689	130,974,645	2.0
Special Payment	16,812,135	15,882,863	5.9
Staff Vehicle Allowance	22,344,097	19,735,833	13.2
Staff Medical Expenses & Insurance	6,962,971	7,148,920	2.6
Staff Welfare	5,896,137	4,936,970	19.4
Overseas Training and Travelling	13,547,075	8,417,392	60.9
Rent & Car Park Rental	88,188,786	81,979,640	7.6
Capital Market Development Expenses - Total	53,736,624	85,159,152	36.9
• Capital Market and Product Development	24,669,537	48,933,373	49.6
• Public Awareness Programmes	13,407,274	20,632,925	35.0
• Educational Programmes	3,480,812	3,636,294	4.3
• International Membership Fees - IOSCO	3,730,324	3,529,660	5.7
• Publicity and Advertising	482,114	233,800	106.2
• Market Surveillance Cost	7,878,105	8,167,459	3.5
• Investigation and Inspection Expenses	88,458	25,641	245.0

- a. As part of the Financial Sector Modernization Project funded by the World Bank, the Commission stands to gain approximately USD 21 million for 11 designated projects. As at the end of the year under review, the Commission received Rs.81.1 million as part of Result Based financial component of the Project. Any specific expense relating to Result Based financial component is not required to be incurred by the Commission other than incurring general expenses amounting to Rs. 1 million during the year under review. Accordingly, the said total amount received was recognized as an income (Government Grant) for the year under review.
- b. Capital Market and Product Development expenditure for the year under review was Rs. 24.7 million. It was mainly included an amount of Rs.20.1million or 81.4 per cent spent for Broker Back Office systems (BBO) and Order Management System (OMS). Further, an amount of Rs. 3.4 million or 13.8 per cent was incurred for Investor Forum held in Singapore in 2019.
- c. As per the Section 14B (2) (a) of the Securities and Exchange Commission Act (SEC Act) No. 36 of 1987, it is authorized to pay out of the Cess imposed under the said Act for the purpose of developing the securities market. Accordingly, 11.8 per cent of the total

expenditure had been spent in the year under review for the capital market development activities as compared with 18.1 per cent in the preceding year.

3. Operating Review

3.1 Operational Inefficiencies

	Audit Issue	Management Comment	Recommendation
(a)	Out of 37 cases handled by the Investigations Division during the year under review, investigations of 4 cases had been concluded and 1 case had been closed due to lack of evidence during the year under review. The investigations of 15 cases are in reporting stage and other investigations of 17 cases which were registered from July 2013 to October 2019 were in progress as at the end of the year under review.	An action plan has been put in place in order to expedite and complete the pending investigations.	Priority should be given to complete all outstanding investigations.
(b)	Five Regulatory papers including papers on Listing Rules initiated by the Corporate Affairs Division during the year under review had not been discussed at the Regulatory Committee and Members of Commission even up to 30 September 2020.	The Regulatory Committee Meetings were not taken place during the year under review. However, necessary actions have now been taken to organize Regulatory Committee Meetings on a regular basis to discuss pending Regulatory Committee Papers.	Need to conduct Regulatory Committee meetings accordingly.
(c)	Implementation of Delivery Versus Payment (DvP) in sequentially implementing the Central Counter Party Mechanism (CCP) jointly with Colombo stock Exchange (CSE) was planned to complete at the end of first quarter of year 2018 and it was extended to first quarter of year 2019. However, implementation of the DvP settlement model had been in progress as at 30 September 2020.	It is important to note that implementation of DVP system is a responsibility of the Colombo Stock Exchange (CSE) where the Commission provides regulatory guidance to implement the same. Hence, acceleration of the implantation process of the DvP system is beyond the control of the Commission. Further, the CSE is currently facing challenges in relation to importation of equipment from India relating to the same. However, the Commission is following up on the same with the CSE on a regular basis.	Expedite the following up process to complete the DvP implementation in sequentially implementing CCP.

- | | | | |
|-----|--|--|---|
| (d) | A sum of Rs.57.3 million had been budgeted to the Capital Market Development which is authorized by the Section 14 B 2 (a) of the SEC Act No. 36 of 1987 to pay out of the Cess imposed under the said Act for the year under review and a sum of Rs. 24.7 million had been incurred during the year under review for the said purpose. However, any amount relating to the CCP project (a sum of Rs. 12.3 million had been budgeted.) and promotional campaign for units trust (a sum of Rs. 10 million had been budgeted.) had not been incurred during the year under review. | Budgeted cost for CCP consultancy fees was not spent due to contract dispute and on-going negotiations to reach an acceptable resolution. In addition, other Capital market development activities, including road shows and unit trust outreach program have been delayed due to Easter Sunday attacks, political uncertainty and presidential elections took place in 2019. | Give priority to develop the capital market. |
| (e) | A sum of 29.1 million had been budgeted to the Public Awareness which is authorized by the Section 14 B 2 (a) of the SEC Act No. 36 of 1987 to pay out of the Cess imposed under the said Act for the year under review and a sum of Rs. 13.4 million or 46 per cent had only been incurred during the year under review for the said purpose. | Quiz program for A/L Students could not be conducted due to the Presidential election. Seminar series on the new SEC Act 2018 was not conducted and most of the publications including Ayojanayata Mulapuramu book were not printed or reprinted in absence of the relevant sections of the new SEC Act. Investor/SME seminars and World Investor Week 2019 Programs too were not held due to the impact of Easter attack and presidential election. | Give priority to develop the capital market. |
| (f) | As per the Inland Revenue Act No. 24 of 2017, the Commission is liable for the income tax with effect from 01 April 2018. However, income tax for the years of assessment 2018/2019 and 2019/2020 had not been paid by the Commission even up to 30 September 2020. Income tax payable for the years of assessment 2018/2019 and 2019/2020 was Rs. 12.7 million and 20.6 million respectively. | The Commission by way of its letter addressed to Director General of the Department of Fiscal Policy of the Ministry of Finance, Economic and Policy Development requested to restore the tax exemption as enjoyed until the year of assessment 2017/2018 in pursuance of the new tax law. The Commission currently awaits a response. | Take immediate actions to avoid the non-compliance with the said Act. |

3.2 Human Resources (HR) Management

	Audit Issue	Management Comment	Recommendation
(a)	<p>In terms of Section 43 (2) of the Securities 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 allowance, monthly allowance, staff medical expenses, staff vehicle allowance and special payment were decided time to time by the Members of Commission.</p> <p>However, as per the recommendation of the Committee on Public Enterprises (COPE) dated 18 September 2018, Commission should seek the concurrence of the National Pay 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 30 September 2020.</p>	<p>The Commission sought a legal opinion from the Hon. Attorney General in respect of the aforesaid matter and in response Hon. Attorney General has advised that the Commission is not required by law to obtain any prior approval or sanction pertaining to its decisions on the recruitment and remuneration of its employees.</p>	<p>Seek to obtain the concurrence of the National Pay Commission with respect to the salaries and emoluments offered to its staff as per the recommendation of the Committee on Public Enterprises.</p>
(b)	<p>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 personnel in terms of the directive issued by the Secretary to the Treasury dated 31 March 1992 that is evident that the Commission</p>	<p>As per the aforesaid opinion of Hon. Attorney General, it is not necessary for the Commission to obtain the approval of the Department of Management Services of the Ministry of Finance, Economic and Policy Development on the matters pertaining to recruiting employees and increasing the salaries and allowances of their employees.</p>	<p>Obtain the approval of the Department of Management Services for the increased Cadre of 41.</p>

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, 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. But, such an approval from the Department of Management Services for the increased Cadre of 41 had not been obtained by the Commission.

- (c) It was observed that the post of Director Capital Market Development, Director Investigations, Director Human Resources, Director Supervision and Director Finance and Administration under the approved Cadre as at 31 December 2017 were remained vacant as at 30 September 2020. The Commission has already taken necessary steps to fill the aforementioned vacancies on an urgent basis. Give priority to fill the vacant positions.
- (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 Commission on behalf of him from 20 April 2016 to 31 August 2018 was Rs.5,212,815. As per the recommendation of the Committee on Public Enterprises (COPE) dated 18 September 2018, the Commission should stop paying salary and make arrangements to recover total The Commission has discontinued the payment of the half month salary to the interdicted employee and recognized the amount paid as a receivable balance in the financial statements for the year ended 31st December 2019. Further, the Commission has already sent multiple reminders via letters to settle the aforesaid amount of Rs. 5.2 Million. Expedite process to recover total paid salary as per the recommendation of the Committee on Public Enterprises.

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 even up to 30 September 2020.

4 Accountability and Good Governance

4.1 Budgetary Control

Audit Issue	Management Comment	Recommendation
-----	-----	-----
Significant variances ranging from 33 per cent to 354 per cent were observed in 18 budgeted and actual expenditure items thus, indicating that the budget had not been made use of as an effective instrument of management control.	The expenses in relation to capital market development, public awareness and educational programs were under spent due to the adverse impact of the Easter attacks occurred in April 2019.	Need to use the Budget as an effective instrument of management control.