

1.1 Opinion

The audit of the financial statements of the Securities and Exchange Commission of Sri Lanka, (“the Commission ”) for the year ended 31 December 2020 comprising the Statement of Financial Position as at 31 December 2020 and the Statement of Financial Performance, Statement of Changes in net assets 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 2020, 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 Securities and Exchange Commission of Sri Lanka for the year ended 31 December 2020 had resulted in a deficit of Rs.385.2 million before taking into account the transfers from the Cess Fund towards net operational expenditure and it was reported the deficit of Rs. 375.4 for the preceding year. The main reason for increasing deficit by Rs. 9.8 million or 14.4 per cent as compared with preceding year was the reduction of grant to Rs. 11.7 million under the Financial Sector Modernization Project.

2.2 Trend Analysis of major Income and Expenditure items

Analysis of major income and expenditure items of the Commission during the year under review, as compared with the preceding year are shown below.

	2020	2019	Difference as a percentage
	Rs.	Rs.	
<u>Income of the Commission</u>			
Interest Income	5,360,805	3,728,019	43.79
Government Grant	11,720,560	81,124,254	(85.55)
<u>Expenditure of the Commission</u>			
Staff Salaries	132,419,676	128,380,689	3.15
Special Payment	16,606,045	16,812,135	(1.23)
Staff Vehicle Allowance	23,298,500	22,344,097	4.27
Staff Medical Expenses & Insurance	7,914,882	6,962,971	13.67
Staff Welfare	4,052,758	5,896,137	(31.26)
Overseas Training and Travelling	2,309,872	13,547,075	(82.95)
Rent & Car Park Rental	96,216,435	88,188,786	9.1
Capital Market Development Expenses - Total	32,376,005	53,736,624	(39.75)
• Capital Market and Product Development	16,920,166	24,669,537	(31.41)
• Public Awareness Programmes	1,354,648	13,407,274	(89.9)
• Educational Programmes	1,609,193	3,480,812	(53.77)
• International Membership Fees – IOSCO	3,684,862	3,730,324	(1.22)
• Publicity and Advertising	0	482,114	(100)
• Market Surveillance Cost	8,795,002	7,878,105	11.64
• Investigation and Inspection Expenses	3,134	88,458	(96.46)

- a. As part of the Financial Sector Modernization Project funded by the World Bank, the Commission stands to gain approximately USD 10 million for 11 designated projects. As at the

end of the year under review, the Commission received Rs.92.84 million in total (Rs. 81,124,254 in 2019 and Rs. 11,720,560 in 2020) 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 2019. Accordingly, the said amounts received were recognized as income (Government Grant) for the year under review and previous year. Further, a sum of Rs. 558,060 received during the year under review as part of the investment project financing component had not been used for the intended purpose in the year 2020.

- b. Capital Market and Product Development expenditure for the year under review was Rs. 16.9 million. It was mainly included an amount of Rs16.8 million or 99.4 per cent spent for Broker Back Office systems (BBO) and Order Management System (OMS).
- 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, 7.4 per cent of the total expenditure had been spent in the year under review for the capital market development activities as compared with 11.8 per cent in the preceding year.

3. Operating Review

3.1 Operational Inefficiencies

Audit Issue	Management Comment	Recommendation
a. Out of 32 cases handled by the Investigations Division, 11 cases had been concluded and 21 investigations which were registered from July 2013 to October 2019 were in progress as at the end of the year under review.	By 30 September 2021, the Investigations Division was able to submit 9 Investigation Reports and other reports to the Commission and the Surveillance and Investigations Committee of the Commission. Consequently, out of 32 investigations handled by the Investigations Division in 2020, only 12 investigations were in progress as at 30 th September 2021. Out of those 12 investigations, 5 investigations are at their final stage of completion. The Division is planning to complete the remaining 7 investigations within a reasonable time period.	Expediate the process of completing outstanding investigations.
b. Implementation of Delivery Versus Payment (DvP) in sequentially implementing the Central Counter Party Mechanism (CCP) was planned	The Colombo Stock Exchange (CSE) is the implementing agency and the Commission is facilitating this initiative by providing policy level guidance to the CSE in consultation with the DvP	Expedite the following up process to complete the DvP implementation

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 31 December 2020.

Expert commissioned under Financial Sector Modernization Project (FSMP). However, due to Covid-19 pandemic, significant consumption of time for importation of required hardware & other requirements, the implementation process had been taken more time than envisaged. Nevertheless, the Commission since inception promptly followed up the DvP implementation by approving required rules & regulations and performing due oversight function. The CSE completed the implementation of a DvP system & enhanced margin model and went live on 16th August 2021.

Further, the Central bank of Sri Lanka (CBSL) reiterated that they had already taken steps to implement a CCP for Government Securities and once such process is completed the CBSL will arrange to on-board the SEC by extending their CCP for equity securities.

- | | | |
|---|---|--|
| <p>c. A sum of Rs.53.5 million had been budgeted to the Capital Market and Product Development for the year under review 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 and a sum of Rs. 16.9 million or 32 per cent had only been incurred during the year under review for the said purpose.</p> | <p>Conducting Road Shows (Budgeted Rs. 8 million) and Promotional Campaign for Unit Trusts (Budgeted Rs. 10 million) were not done Due to the Covid -19 pandemic prevailed during 2020. Consultancy Fees in relation to the CCP project (budgeted Rs. 12.5 million) - It has been decided not to make this payment to the CSE.</p> <ul style="list-style-type: none"> ▪ Broker Back Office and Order Management Systems (BBO & OMS) (Budgeted Rs. 23 million, Actual 16.9 million) - Funds are reimbursed based on the supporting documents submitted by the CSE to the Commission for the implementation of BBO & OMS by broking firms. ▪ Accordingly, based on the supporting documents furnished by the CSE, the Commission has reimbursed Rs.18.6 Mn to the CSE during 2020. However, | <p>Give priority to develop capital market</p> |
|---|---|--|

in order to reimburse the remaining funds, the CSE is required to provide necessary supporting documents to the SEC.

- | | | |
|---|---|--|
| <p>d. A sum of 24.1 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. 1.4 million or 5.8 per cent had only been incurred during the year under review for the said purpose.</p> | <p>The Covid-19 pandemic led to two lockdowns and placed restrictions on the investor outreach programmes that the External Relations division had planned and budgeted for the year 2020. The division had to resort to online investor awareness programmes mainly via social media and the content was designed in house which led to a reduction in cost.</p> | <p>Give priority to develop capital market</p> |
| <p>e. As per the Inland Revenue Act No. 24 of 2017, the Commission and its Funds are 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 been paid by the Commission in November 2020 and February 2021. Accordingly, there is possibility to charge penalties by the Department of Inland Revenue for the delay in payment of taxes for the respective years of assessments.</p> | <p>The Commission requested an exemption from income tax in terms of the new Inland Revenue Act No. 24 of 2017, as was available under the previous Inland Revenue Act from department of Inland Revenue and Fiscal policy department of General Treasury.
The final responses from the Department of Fiscal Policy, clarifying our requests on tax exemption status were received on 09th November 2020. Since the delay in making the payments were purely due to awaiting clarifications from relevant authorities, the Commission believes that the chances of imposing penalties will be very remote since the reason for non-payment was informed to the IRD at the time of filling the returns.</p> | <p>Comply with Income tax laws in making payments.</p> |

3.2 Human Resources (HR) Management

Audit Issue	Management Comment	Recommendation
<p>a. In terms of Section 43 (2) of the Securities</p>	<p>The Commission sought a</p>	<p>Comply with</p>

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.

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.

However, as per the recommendation of the Committee on Public Enterprises (COPE) dated 18 September 2018, Commission should seek the concurrence of the National Salaries and Cadre 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 2021.

- b. Approved Cadre of the Commission as at 22 January 2018 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 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.

legal opinion from the Attorney General in respect of the aforesaid matter and in response, 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.

COPE recommendations

The Commission sought a legal opinion from the Attorney General in respect of the aforesaid matter and in response, 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

Comply with relevant circulars.

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 posts of Deputy Director General, Director Capital Market Development, Director Investigations, Director Supervision, Assistant Director legal and Enforcement and Assistant Director Capital Market Development which are under the approved Cadre as at 22 January 2018 were remained vacant as at 31 December 2020.

Although it was challenging to fill all vacancies due to the existing remuneration structure of the Commission or inability to find suitably qualified candidates with required attributes, the Commission conducted several interviews to fill the vacancies exist in senior management positions including Director Capital Market Development, Director Investigations, Director Supervision, Director Human Resources to date. However, the Commission will continue to take necessary steps to fill the vacancies depending on the operational requirements of the organization.

Expedite the recruitment process for senior management 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

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 31 December 2020. Further, the Commission has already sent

Expedite the process to recover total paid salary as per the recommendation of the COPE.

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 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 31 December 2020.

multiple reminders via letters to settle the aforesaid amount of Rs. 5.2 million. An acknowledgement was sent by him to the Commission. However, he has not deposited the money to date.

4 Accountability and Good Governance

4.1 Budgetary Control

Audit Issue

Significant variances ranging from 32 per cent to 175 per cent were observed in 14 budgeted and actual expenditure items thus, indicating that the budget had not been made use of as an effective instrument of management control.

Management Comment

Due to the changes in assumptions in actuarial valuation as at the reporting date, actual gratuity expense exceeded the budget.
Expenses relating to Executive subsistence, advertising recruitments were under spent due to impact of COVID 19 pandemic.
Amount budgeted for capacity building on new SEC Act was not incurred during the year 2020.

Recommendation

Need to use the budget as an effective instrument of management control.