

Securities and Exchange Commission of Sri Lanka - 2023

1. Financial Statements

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 2023 comprising the Statement of Financial Position as at 31 December 2023 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 material accounting policy 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 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 2023, 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 Auditor's Responsibilities for the Audit of the Financial Statements

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 had resulted in a deficit of Rs.446.6 million before taking into account the transfers from the Cess Fund towards excess of expenditure over income and it was reported a deficit of Rs. 331.2 million for the preceding year. The main reason for increasing the deficit by Rs. 115.4 million or 34.8 per cent as compared with preceding year was the increase of Administration & Establishment Expenses and Personal Costs incurred during the year under review by Rs. 56.2 million and Rs. 81.1 million respectively.

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.

	2023	2022	Difference as a percentage
	Rs.	Rs.	%
<u>Income of the Commission</u>			
Educational Programmes	11,629,061	8,671,966	34.0
Government Grant (FSMP)	176,438,871	172,252,739	2.4
<u>Expenditure of the Commission</u>			
Staff Salaries	202,907,059	160,983,569	26.0
Staff Welfare and Other Staff Related Payments	49,696,830	37,965,470	30.9
Overseas Training and Travelling	13,522,257	7,081,485	90.9
Rent & Car Park Rental	140,069,454	110,895,458	26.3
Capital Market Development, External Relations, Capital Market Education, Surveillance and Investigation Expenses - Total	36,029,791	50,328,063	(28.4)
• Capital Market and Product Development	0	19,050,659	(100.0)
• Public Awareness Programmes	21,773,762	10,278,137	111.8
• Educational Programmes	1,959,364	1,678,495	16.7
• Publicity and Advertising	0	147,015	(100.0)
• Market Surveillance Cost	5,278,991	11,820,060	(55.3)

- a. As part of the Financial Sector Modernization Project (FSMP) funded by the World Bank, the Commission stands to gain approximately USD 10 million; USD 2 million under result based financing component and USD 8 million under the Investment based financing component. As at the end of the year under review, the Commission received Rs. 533.39 million in total (Rs. 81,124,254 in 2019, Rs. 11,720,560 in 2020, Rs. 104,804,128 in 2021, Rs. 171,674,294 in 2022, and Rs. 164,073,632 in 2023) as part of Result Based financial component of the Project. Further, under Investment based Financing Component of the FSMP, funding was made available to the Commission to procure identified goods and consultancy services and for staff capacity building. As at the project closure, the World Bank had disbursed an amount of USD 519,059.54 (Rs. 163,324,066.66) to the Commission.
- b. There are no any Capital Market and Product Development expenditure incurred during the year under review and it was Rs. 19.05 million in the previous year. However, Public awareness program expenditure for the year under review was Rs. 21.77 million in the year 2023 and it was Rs. 10.28 million in the previous year reflecting an increase of Rs. 11.49 million or 111.8 per cent during the year under review.
- c. As per the Section 156 of the Securities and Exchange Commission Act No. 19 of 2021 (SEC Act), it is authorized to utilize the Cess imposed under the Act for the purpose of developing the securities market, meeting all expenditure incurred by the Commission in the management, administration and operation of the Commission in the exercise, performance and discharge of its duties and functions and other purposes. Accordingly, it was observed that a sum of Rs. 446.66 million had been transferred from Cess Fund to finance the expenses of the Commission. Total expenditure of the Commission was Rs. 665.58 million and no any expenditure had been spent during the year under review for the capital market development activities. However, as per the revised budget for the year 2023, the Commission had allocated a sum of Rs. 3,000,000 for the capital market development activities during the year under review.

3. Operating Review

3.1 Conducting of Investigations by the Commission

Audit Observation	Management Comment	Recommendation
(a) According to the Section 16(r) of the SEC Act, the Commission shall be to inquire and conduct investigations into any activity of a market institution, market intermediary, a registered person, a listed public company or a listed foreign entity. Further, in terms of the Section 16(s) of the SEC Act, the Commission shall conduct investigations into any alleged violation or contravention of the provisions of the SEC Act or any regulation or any rule or directive made or any instruction given there under or by any person and to take any enforcement measures provided under the SEC Act as considered necessary by the Commission. According to the	The Investigations Division of the Commission conducted 86 Investigations during the year 2023 and concluded 26 investigations as at 31 December 2023. Accordingly, the Division had 60 on-going investigations as of 31 December 2023. The Commission expedited the Investigation process during the year in order to conclude aforesaid investigations by	Need to further expedite investigation process.

information made available, there had been 62 ongoing investigations (including 5 sub matters of investigations) carried forward from the year 2022 and the Commission resolved to initiate 24 new investigations during the year 2023. The progress of conducting investigations as at 30 June 2024 is as follows.

Nature of Investigation	Total investigations to be done in 2023	Investigations received during 2024	Position as of 30 th June 2024		
			Number of Concluded Investigations	Report submitted to the Commission and recommended to further review or further investigation	In progress
Insider Dealing	26	2	14	8	6
Market Manipulation	42	-	30	4	8
Market Manipulation/Insider Dealing	4	-	1	2	1
Front Running	6	-	5	1	-
Insider Dealing/Front Running	1	-	-	1	-
Front Running/any market misconduct	1	-	1	-	-
Market Manipulation & violation of Stockbroker Rules	1	-	1	-	-
Market Misconduct under S. 132 (a)	1	-	-	-	1
Takeovers and Mergers Code	1	-	-	1	-
Violation of the SEC Act and Rules	1	-	1	-	-
Market misconduct	1	1	1	-	1
Market Manipulation/Front Running	1	-	1	-	-
Total	86	3	55	17	17

initiating several measures including an appointment of Oversight Committee for Investigations and Enforcement. As a result, the Commission was able to conclude 55 out of 86 investigations as of 30 June 2024. Further, reports pertaining to 17 investigations have been referred to the Director Investigations for further review, and 17 investigations are being conducted by the Investigations Division as at the end of June 2024.

Out of pending 17 investigations as at 30 June 2024, five investigations were initiated before 2023.

- (b) The Commission at its 487 meeting held on 14 July 2023 had decided to appoint an Investigation Oversight Committee comprising three members of the Commission and the Committee had met 13 times during the period from July 2023 to May 2024. However, it was not observed an approved Terms of Reference (TOR) or framework on as to how meetings of the Committee are arranged and conducted.

A TOR for the above mentioned Oversight Committee for Investigations and Enforcement will be submitted to the Commission for its approval.

Need to have a TOR for the Committee

3.2 Human Resources Management

Audit Observation

Management Comment

Recommendation

- (a) (i) It was observed that the post of Director Capital Market Development, Director Surveillance, Director External Relations, three out of nine Assistant

The Commission approved the above carder for a period of five years commencing from 2021.The

Need to fill the remaining key positions.

Directors, four out of nine senior managers, four out of sixteen managers, seven out of twenty two senior assistant managers and 24 out of 49 assistant managers, which are under the executive category of the approved Cadre of the Commission were remained vacant for a considerable period as at 10 June 2024. Remaining vacant of managerial positions may have been effected to the effective functioning of the Commission.

(ii) According to the SEC Act, Development of securities markets in Sri Lanka is one of the powers, duties and functions of the Commission. However, no permanent employee had been appointed for the position of the Director, Capital Market Development and it is being handled on acting basis for more than 3 years as at 30.06.2024. Further, the Commission had not called applications from eligible candidates to fill this position after September 2022.

(iii) Although advertisement to recruit assistant managers had been published in January 2024, they were not recruited till end of June 2024.

(b) Appointment of Acting Director General

According to the Section 19 (1) of the SEC Act, the Minister shall on the recommendation of the Commission, appoint a Director-General of the Commission, who shall be its chief executive officer. The conditions of employment including remuneration of the Director-General shall be determined by the Commission. Further As per the Section 19(4) of the above Act, the Director-General may, with the approval of the Commission, whenever he considers it necessary to do so, delegate to any officer and servant any power, function or duty conferred or imposed on or assigned to him by this Act and such officer or servant shall exercise, discharge and perform such power, function or duty subject to the general or special directions of the Director-General. However, according to the Circular Letter of Director- HR and Organization Transformation dated 16 April 2024, the Commission has appointed Acting Director General and transferred delegated authority to him to discharge the responsibilities of the office of the Director General as Director General is out of office

Commission had called for applications and conducted interviews to fill most of the aforementioned vacancies. The Commission has not been able to identify suitable persons for these positions. Whenever, a suitable candidate was identified, such candidates have not been keen to take up the positions mainly due to the low salaries that were offered to them. The Commission already identified five key positions as critical for filling in the financial year 2024. Two of these positions have already been filled and actions have been initiated to recruit the remaining three. The rest will be filled in due course based on the needs of the institution. The Deputy Director General oversees the Capital Market Development (CMD), External Relations (ER), and Capital Market Education (CME) divisions.

In April 2024, the Director General (DG) of the commission experienced a sudden medical condition that required him to be hospitalized. To maintain the commission's operation, the decision was made to appoint an acting DG. Due to the uncertain duration of the DG's absence, the commission selected the Deputy Director General as the acting DG, as he was the next senior officer. This decision was made in compliance with the Establishment Code since the Act did not specifically address this situation. The appointment of the Deputy Director General as the acting DG ensured the organization's smooth functioning during the DG's medical leave.

Recommend to obtain the Minister's Concurrence.

due to a personal exigency. Though the appointing authority of the Director General is the Minister, No any approval/concurrence from the Minister had been obtained from the Minister regarding this appointment.

(c) Recruitment of Management Trainees

The commission advertised to recruit management trainees in July 2023 and recruited 10 such trainees in early 2024. Following observations are made in this regard.

- (i) According to the advertisement, it was stated that management trainees will be selected after a through screening process. However, the details of the screening process (such as conducting a written examination and/or one or more interviews) had not been stated in the advertisement. Further, the amount of allowance expected to be payable to selected trainees had not been mentioned in the advertisement.
- (ii) The scheme of recruitment (SOR) approved by the Commission at its 445th meeting held on 13 January 2021 and effective from 01 January 2021, does not contain the ways of recruiting management trainees to the Commission.
- (iii) After the receipts of more than 1,000 applications, the Commission decided to conduct a written examination as the initial step to select suitable candidates with the support of the external party. However, it had not been communicated to the candidates at the time of applying for the position.
- (iv) Though written examination had been conducted by an external party, the examination papers had been prepared internally.

The Commission follows the same recruitment process for all vacancies. Salaries, screening process, and allowances are generally not included in the advertisement. Only the shortlisted candidates were informed of the written examination and those who were successful at the written examination were called for interviews. The examination paper comprised of questions on the Sri Lankan Capital Market, foreign Capital Markets, General knowledge, IQ etc. The existing SOR is now being updated with the inclusion for the recruitment of management trainees.

Recommend to include the screening process and allowances in the advertisement and update SOR with the inclusion of management trainees.

(d) Establishment of a Code of Conduct

In terms of the Section 20(4) of the SEC Act, the Commission shall establish a code of conduct which shall be applicable to the officers and servants of the Commission. The present regulation regarding conduct of members and Employees had been used since 1997 and it had not been updated to include the above reference of the SEC Act.

Comments noted and the Commission is in the process of updating the Establishment of the Code of Conduct.

Need to update the exiting Code of Conduct.

3.3 Entering into Service Level Agreement (SLA) with service providers

Audit Observation	Management Comment	Recommendation
It was observed that eleven (11) SLAs had been entered into with respective service providers with considerable delays after the commencement date of the validity period of the service agreement.	Even though the SLA has been delayed signing, there were no service interruptions from any vendor during the period. It is ensured that, no system performance/uptimes are impacted during the lapse of any SLA. Steps will be taken to ensure that SLAs are signed on or before the effective dates.	Need to sign the SLAs on or before the effective dates of the agreements.

3.4 Granting the staff loan facility equivalent to the value of ten months' gross salary to the staff

Audit Observation	Management Comment	Recommendation
The Commission at its 485 th meeting decided to restructure the existing staff loan facility equivalent to the value of ten months' gross salary or Rs. 2,000,000 whichever is less subject to conditions. One of the purposes to be eligible for the staff loan facility is "such other purposes as may in the opinion of the Director General deserve financial assistance". However, details regarding as to how Director General determines the instances of giving financial assistance are not stated in the above Commission decision.	Comments noted and eligibility criteria to be revisited immediately.	Need to the revisit the eligibility criteria.

3.5 Conducting market surveillance of securities transactions

Audit Observation	Management Comment	Recommendation
According to the SEC Act, the Commission shall carry out surveillance of securities transactions in the Colombo Stock Exchange with a view to detecting and preventing transactions which transgresses the SEC Act. According to the information made available, the Commission had generated 12 surveillance referrals and one surveillance note during the year 2023. Further, the Commission monitors information shared on various social media platforms and it is suggested to further monitoring on various posts that are sharing in	The Commission sought clarifications from Stockbrokers, Investment advisors, Compliance Officers and Investors via phone calls, letters, and statement recordings for various suspected offences. Consequently, timely and appropriate actions are carried out pertaining to misconduct, considering the context of the social environment and the prevailing market conditions. Accordingly, clarifications were	Need to further monitoring on various posts that are sharing in the social media platforms about target pricing, investment advising.

the social media platforms about target pricing, investment advising etc. Further, the Commission had allocated Rs. 16,409,980 as market monitoring & surveillance cost in the budget, it had only spent Rs. 5,278,991 or 32 per cent during the year 2023.

sought promptly via telephone calls from investors pertaining to observations, and some observations were reported to the relevant social media platforms by SEC's Official Facebook / YouTube Account, for "Posting Inappropriate Content". During the year 2023, identified investors were issued "Warnings" and some identified investors were issued "Letter of Caution".

3.6 Conducting meetings of the HR & Remuneration Committee and Risk Committee

Audit Observation	Management Comment	Recommendation
According to the published information, the Commission had appointed two sub committees namely, Risk Committee and HR & remuneration Committee. However, Terms of Reference (TOR) for those Committees had not been available.	The draft TORs for the two committees to be submitted for the approval of the Commission.	Need to have approved TORs.