



OUR Mission

“To promote, develop and maintain a Securities Market that is fair, efficient, orderly and transparent”

OUR Objectives

The Act provides for:

the creation and maintenance of a market in which securities can be issued and traded in an orderly and fair manner;

the protection of the interest of investors;

the operation of a Compensation Fund to protect investors from financial loss arising from the failure of a licensed stock broker or licensed stock dealer to meet contractual obligations; and

the regulation of the securities market and to ensure that professional standards are maintained in such market.



CORPORATE INFORMATION

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Sri Lanka

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Web - www.sec.gov.lk

Legal Form - Securities and Exchange Commission of Sri Lanka (SEC)
was incorporated by Act No. 36 of 1987 as amended by
Act No. 26 of 1991 and Act No. 18 of 2003.

Accounting year end - 31 December

Auditors - The Auditor General

Bankers - Bank of Ceylon
Standard Chartered Bank
Sampath Bank
Hongkong & Shanghai Banking Corporation Limited



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CHAIRMAN'S REVIEW





The performance of the stock market during the year 2005 was nothing short of remarkable. The market picked up momentum during the last quarter of the year which lasted upto November 2005. Thereafter, the market turned somewhat bearish, but with the confidence gained due to peace initiatives the market has since stabilized.

During the year under review there were two Initial Public Offerings (IPO). The Dialog Telecom IPO substantially enhanced the market capitalization of the Colombo Stock Exchange (CSE). Dialog subsequently has become the first billion dollar market capitalized company in the CSE. We are pleased to state that the settlement cycle was reduced to T+3 and T+4 for purchases and sales respectively during the year. The introduction of negotiated brokerage fees in 2005 for trades over Rs.100 million is also a positive step taken towards developing the market.

It was a noteworthy achievement to have the honour of hosting the 30th Annual Conference of the International Organization of Securities Commissions (IOSCO) in Sri Lanka. There were over 100 countries which were represented at this Conference. We acknowledge with gratitude the confidence placed by the international community of regulators in the SEC of Sri Lanka and our country by choosing Colombo as the venue of this event.

In pursuit of our own market development endeavors, we have signed a MOU with the Central Bank of Sri Lanka to introduce the DEX system to activate the secondary market for government securities. Currently, the debt market in Sri Lanka has not reached the levels expected and therefore several initiatives are underway to activate this segment.

The revision of the Take-overs and Mergers Code has continued during the year with a view to address certain ambiguities in the application of the Code.

We have initiated the regulation of market intermediaries registered with SEC in the categories of Margin Providers, Investment Managers, Underwriters, Clearing Houses and Credit Rating Agencies. We are in the process of finalizing the rules for implementation.

The Secretariat has also developed a three year Corporate Plan for the period 2006 through 2008. The Corporate Plan re-examined all internal processes, resource requirements, policies and procedures subsequent to comprehensive consultation with staff members.

The Corporate Plan also focused on the following main dimensions of market development:

- To increase the number of Listed Companies while enhancing Corporate Governance practices. It is envisaged that CSE will attract the Apparel, IT, Manufacturing and SMI Sector Companies to the CSE as these companies contribute significantly to the national economy at present. This will result in enhancing the market capitalization of the CSE.
- To expand listed products traded and available on the stock exchange to allow investors to diversify their portfolios and hedge their risks. The SEC is proposing the introduction of derivative products such as Stock Options and Futures to the market.
- To work towards expanding the domestic investor base of the country, which at present accounts for 80% of the total turnover of the CSE. We will at the same time encourage and facilitate foreign investments to the Sri Lankan Capital Market.

Finally my sincere appreciation to the management and the staff of the Secretariat for their commitment and enthusiasm in carrying out their duties. I look forward to their continued support in the coming year.

Gamini Wickremasinghe
CHAIRMAN



MEMBERS OF THE COMMISSION



4 Mr. GAMINI WICKREMASINGHE

CHAIRMAN

Mr. Gamini Wickremasinghe graduated with an MSc in Systems Analysis from the University of Aston, Birmingham, U.K. in 1976 and worked for more than five years for Philips Petroleum Company both in the U.K. and at their European Headquarters in Brussels, Belgium as the IT Manager for Europe/Africa and the Middle-East.

He returned to Sri Lanka in 1983 and founded the Informatics Group of Companies, which today consists of 07 operating Companies.

In 1990, Informatics embarked on an ambitious IT Education project in collaboration with Manchester Metropolitan University, and thereafter with University of Westminster, and Keele University, all of U.K. The Informatics Institute of Technology (IIT) is today the largest private Technology University in Sri Lanka offering both undergraduate and postgraduate degrees from British Universities.

Mr. Wickremasinghe is a Fellow of the British Computer Society and the Fellow of the Chartered Management Institute of U.K.

1 Mr. SUMITH ABEYSINGHE

COMMISSION MEMBER

Mr. Sumith Abeysinghe holds a Bachelor of Arts (Hons.) Degree in Geography (Sri Lanka) and a Masters Degree in Economics (University of New England, Australia).

Mr. Abeysinghe functions as Deputy Secretary to the Treasury. He previously held senior positions in the Ministry of Finance and Planning such as Director General of National Budget and Director of Fiscal Policy and Economic Affairs. He is also an ex-officio Director of Bank of Ceylon.

2 Dr. (Mrs.) RANEE JAYAMAHA

COMMISSION MEMBER

Dr. (Mrs) Ranee Jayamaha holds a Ph.D. in Monetary Economics (UK), M.Sc. in Economics (UK), B.A. (Hons) Sri Lanka.

At present Dr (Mrs) Jayamaha is the Deputy Governor, Central Bank of Sri Lanka.

She is presently serving the following Commissions/Boards:

- Chairperson/Financial Stability Committee
- Chairperson/Financial Sector Cluster
- Chairperson/Credit Information Bureau
- Member/Sri Lanka Insurance Board

Formerly she was:

- A Special Advisor (Economic), Economics & Legal Advisory Services Division, Commonwealth Secretariat, London, 1995-2001
- Advisor/Chief Executive – Ministry of Finance, Financial Sector Reform Committee, 1993-1995
- Secretary, Presidential Commission on Finance & Banking, 1991-1993
- Director/Banking Development Department, Central Bank of Sri Lanka, 1989-1991
- Deputy Director, Senior Economist, Economist/Economic Research Dept, Central Bank of Sri Lanka, 1971-1989.

She has published 18 articles in international journals and 20 in national journals.



3 **Mr. C P E GUNASINGAM**
COMMISSION MEMBER

Mr C P E Gunasingam holds a Bachelor of Science degree from the University of Madras and a Bachelor of Laws degree from the University of Colombo. He was admitted to the Bar as an Advocate in 1973. He is a Fellow Member of the Sri Lanka Institute of Taxation (FTII) and has served as its President for four years. He has served as visiting Lecturer in Taxation at the Sri Lanka Institute of Taxation and Institute of Chartered Accountants of Sri Lanka. He has served as an Assessor of Inland Revenue from 1962 to 1973 and counts 33 years of service as a Tax Practitioner. He has addressed seminars and contributed articles to newspapers and journals on tax related subjects. Mr. Gunasingam served as a Board Member of Peoples Bank. Presently, he serves as a member of the Insurance Board of Sri Lanka and the National Council for Economic Development – Taxation Cluster.

5 **Mr. GRAETIAN GUNAWARDHANA**
COMMISSION MEMBER

Mr. Graetian Gunawardhana was educated at Thurstan College Colombo and studied up to Advanced Level and joined the Royal Ceylon Air Force as an Aircraft Engineering Technician for two years and thereafter served in the Police Department until 1979.

He started his own business as the Founder Chairman of Hands International (Pvt) Ltd, which is an export oriented company with a staff of 3000 workers. He was elected the Entrepreneur of the Year 1999/2000. Mr. Gunawardhana was the recipient of the Gold Award for Exports for the extra large category for many years.

He also served as the Chairman Exporters Association in 2003-2005. He was also the Chairman of the Sri Lanka Taiwan Friendship Association for 5 years. Mr. Gunawardhana was the Director of the American Chamber of Commerce for two years.

Presently he is the Lions District Governor for District 306 B2.

6 **Mrs. SIROMI WICKRAMASINGHE**
COMMISSION MEMBER

Mrs. Siromi Wickramasinghe is a senior banker with over 25 years of experience in the industry and presently functions as a Deputy General Manager of Hatton National Bank. She has held many positions at HNB including Credit Development & Investment Management, Procurement & Expense Control, Corporate Relationship Development, Regulation & Corporate Governance and Administration. She has extensive exposure to global industry best practices having taken part in and contributed to many training and development programmes at some of the world's leading financial centres.

Mrs. Wickramasinghe is also an Attorney-at-Law, Notary Public and Commissioner for Oaths and a Fellow of the Chartered Management Institute, UK where she is the Assistant Treasurer of the Executive Council of the Sri Lanka branch.

7 **Mr. YOHAN PERERA**
COMMISSION MEMBER

Mr. Yohan Perera, a practicing accountant and a Partner at KPMG Ford, Rhodes, Thornton & Company since April 1990.

Mr. Perera is the President of the Institute of Chartered Accountants of Sri Lanka. He has been Vice President, Member of Council and chaired several Committees at the Institute. He is also a Director of the Confederation of Asian and Pacific Accountants (CAPA) a regional accountancy organization affiliated to the International Federation of Accountants (IFAC).

Mr. Perera is an ex-officio Member of the Boards of the Post Graduate Institute of Management (PIM) of the University of Sri Jayawardenapura and the National Institute of Business Management (NIBM).

He is a Fellow Member of the Institute of Chartered Accountants of Sri Lanka (FCA) and the Chartered Institute of Management Accountants of United Kingdom (FCMA).

8 **Mr. D K HETTIARACHCHI**
COMMISSION MEMBER

Mr. D K Hettiarachchi is an Attorney-at-Law by profession. He joined the Department of the Registrar of Companies in 1986 as an Assistant Registrar and was promoted to the position of Registrar of Companies in 1997.

He is also an Ex-officio member of the Sri Lanka Accounting and Auditing Standards Monitoring Board.

Mr Hettiarachchi has many years of management experience.



PRINCIPAL OFFICERS OF THE SECRETARIAT



From Left:

Ms. Ianthie Jayaratne
Director Finance and Administration

Mr. Malik Cader
Director Public Relations and Market Development

Ms. Surana Fernando
Director Corporate Affairs

Mr. Dhammika Perera
Director Investigations

Mr. Channa de Silva
Director General

Mr. Chandu Epitawala
Director Surveillance and Research

Ms. Marina Fernando
Director Legal and Enforcement



ECONOMIC REVIEW

The year 2005 was a decisive year politically and for the economy of the country. The term of the former President ended in 2005 with the presidential election held in November 2005, which saw the election of the current President Hon. Mahinda Rajapakse for a six year term. The election itself was described as relatively peaceful, despite being closely contested by the two main parties. Another significant political event of 2005 was the assassination of the Foreign Minister Mr. Lakshman Kadirgamar. The ceasefire, signed with the LTTE in 2002, was by and large observed until December 2005 by both parties creating a peaceful and stable security environment conducive to development and growth.

The massive Tsunami disaster of December 2004, which struck several Asian Countries had a particularly devastating effect on Sri Lanka. It was the worst natural disaster recorded in the island's history resulting in over 33,000 deaths along the countries' South Eastern coastal belt. Severe damage to roads, rail tracks and infrastructure, homes and to the fisheries and tourism industry invariably had its impact on the entire economy during the first half of the year. The ability of the Sri Lankan economy to recover from the Tsunami and the oil price hike and emerge relatively unscathed is a testimony to the resilience of the economy.

The economy reached the milestone of crossing the US\$ 1,000 per capita income or US\$ 20 billion in Gross Domestic Product. Sri Lanka is the first country in the South Asian region to reach this milestone. However, disparities in income distribution remain a challenge to be addressed. Ominously, inflationary pressures in the economy, partly stemming from a steep rise in world crude oil prices, pushed inflation into double digits. A relatively high budget deficit caused by petroleum and other subsidies as well as partial monetizing of the deficit further contributed to pressure on inflation. The last quarter of the year saw a reverse in this trend easing the escalation of the cost of living.

The currency and the exchange rate however, were relatively stable inspite of the sharp increase in oil importation costs, which was mitigated by robust inflows of remittances from expatriate workers and aid inflows for Tsunami reconstruction projects. The year end gross official reserves stood at US\$ 2.7 billion or 3.7 months of imports. As seen in previous years, the overall balance of payments recorded a surplus inspite of the current account deficit due to trade imbalance. The overall surplus resulted for

official transfers, moratorium on foreign debt repayment and foreign private remittances from Sri Lankans working abroad. The US dollar traded at a relatively narrow range of Rs.98/- to Rs.102.12 during the year.

Along with inflation, the interest rates were pushed up though not fully reflecting actual inflation at times. One year Treasury Bill yields ranged from 8% to 10% during the year. Foreign direct investment was US\$ 234 million while foreign portfolio investment was also significant, lending substantial support to the equity market. At its peak in October 2005, the equity market capitalization reached Rs. 761 billion or approximately 32% of the GDP.

GDP growth recorded an overall real rate of 6%, which exceeded low growth expectations after the Tsunami. Expanding exports of apparel, tea and rubber and Tsunami reconstruction activity contributed significantly to this growth. Towards the latter part of the year, Tsunami affected Tourism and Fisheries sectors showed signs of recovery. The Agriculture sector and service and Manufacturing sectors of the economy also fared satisfactorily. However, investment in the economy other than the Telecommunications sector lagged behind the levels required to achieve the aspired annual GDP growth of 7% to 8%.

The economy is currently going through a momentum of consolidation largely tagged to the peace efforts by the government. There is a high degree of optimism and positive expectations of the economy which is driving the investment growth rate of the country.



EQUITY MARKET – 2005

In the aftermath of the Tsunami disaster on 26th December 2004, it was widely expected that the Colombo stock market would perform poorly in the year 2005. However, the year commenced with a very positive outlook with pledges of billions of dollars as aid from the international community to rebuild the Tsunami damaged infrastructure. In addition, the ceasefire agreement with the LTTE resulted in tangible benefits in the form of improved economic and business climate whilst enhancing positive sentiment in the Colombo stock market.

The All Share Price Index (ASPI) of the Colombo Stock Exchange commenced the year at 1,506.9 points on the back of a stellar 41% growth of the Index in the preceding year. The market rapidly shook off the negative effects of the Tsunami disaster and grew at a measured pace until early September. In between, there were short-lived rallies followed by market corrections. The market proved its resilience time and again by posting gains after each bout of profit taking by investors. During this period, the Colombo Stock Exchange benefited from large strategic deals and strong earnings. The successful IPO by Dialog Telekom Limited in July 2005, the bourse's biggest so far, further boosted sentiment.

Sri Lanka's Stock Exchange was widely regarded as one of the best performing in Asia after gaining as much as 70% by mid November 2005 on strong buying in banking, manufacturing, telecommunication and construction stocks in the run-up to November's Presidential Election. The share market reached a peak just prior to the Presidential Election with the ASPI recording an all time high of 2,551.4 points on 16th November 2005. The MILANKA Price Index (MPI) too reached an all time high of 3,374.0 points on the same day.

However, due to the marked deterioration of the security situation in the North and East of the country during December 2005, the share market began to plummet. In view of the escalating violence which put serious strain on the fragile truce between the Government and the LTTE, the market began to re-rate lower from the high price to earnings ratio of 17 times reached in October 2005. The market decline continued through December as investors feared a collapse of the ceasefire agreement that has been in place since February 2002.

The year closed with the ASPI at 1,922.2 points. Despite the sharp decline in the last 6 weeks of the year, the Index

still managed to record a creditable 27.6% growth for the year 2005. The MPI recorded 18.2% growth. The market capitalization as at the end of the year stood at a record LKR 584.0 billion compared to LKR 382.1 billion in 2004.

One of the notable developments during the year under review was the decision by California's biggest pension fund, CalPERS, to include Sri Lanka in its investment list for 2005. The California Public Employees' Retirement System, the largest public pension fund in the US that has about US\$ 184.6 billion in assets (*as at February 2005*), in an annual review of emerging markets for 2005, was permitted to invest in the equity market in Sri Lanka.

PRIMARY MARKET

There were five new listings comprising two Initial Public Offerings (Dialog Telekom Ltd. and Sierra Cables Ltd.) and three through the modality of introduction (Pan Asia Banking Corporation Ltd., Vidullanka Ltd. and Seylan Merchant Leasing Ltd.) during the year under review. Market liquidity was well enhanced with Dialog Telekom Ltd.'s share issue raising the highest amount of capital ever raised at the Colombo Stock Exchange (CSE). Dialog Telecom became Sri Lanka's only billion dollar listed company. HDFC Bank, which was already listed on the CSE, made an IPO to the public during the year. The total capital mobilised through these IPO's amounted to LKR 9,698 million.

The level of activity in the stock market has shown a significant increase in year 2005 compared with the previous year. The annual turnover for the year was LKR 114.5 billion with a healthy average daily turnover of LKR 482 million. The average daily turnover has increased by

SECONDARY MARKET			
Year	Total Turnover (SLR mn)	Average Daily Turnover (SLR mn)	No of Trades
2000	11,049	46	160,277
2001	14,057	58	159,723
2002	30,523	128	283,126
2003	73,837	308	482,954
2004	59,052	246	645,083
2005	114,599	482	1,100,451

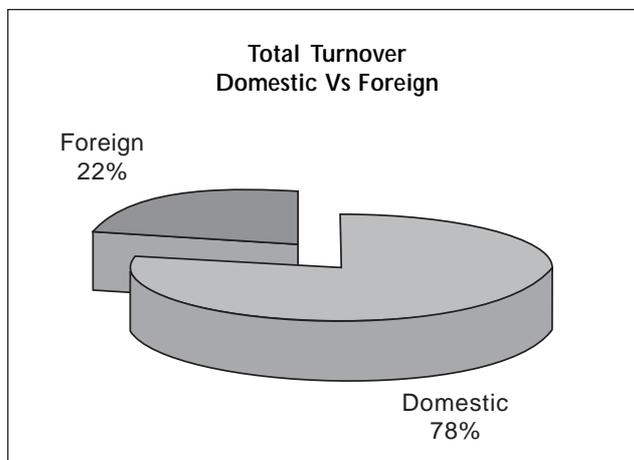
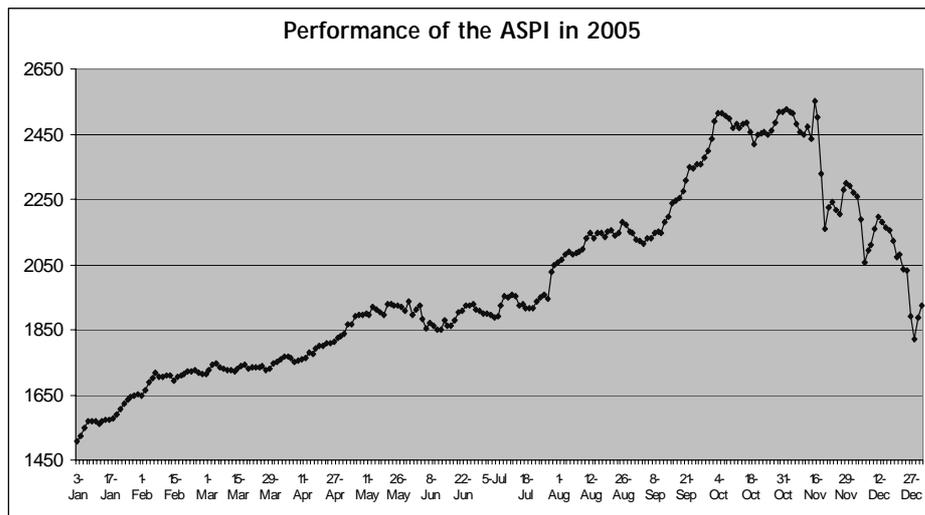


96% this year as against LKR 246.0 million in 2004. Local investors accounted for 78% of the annual turnover whilst foreign contribution was 22%. A total of 1,100,451 transactions were concluded with 5,128.2 million shares being traded. Foreign participation showed a remarkable increase during this year, registering purchases of LKR 27,712.4 million and sales of LKR 21,567.9 million, resulting in a net foreign inflow of LKR 6,144.5 million. When compared with the previous year, foreign purchases and sales increased by 145.7% and 112.0% respectively.

During the year under review, Price Indices of 15 Sectors

showed a positive growth, whilst 5 Sectors declined. The highest growth of 111% was recorded in the Motor Sector, whilst Telecommunications and Land and Property Sectors appreciated by 74% and 54% respectively. The Power and Energy Sector recorded the highest decline of 21% in year 2005.

The year 2005 can be named as the best ever for the CSE in terms of annual turnover, market capitalisation, highest number of trades and highest amount of funds raised through IPO's. It has been a highly successful year for the Colombo bourse, market intermediaries and investors alike.





CORPORATE AFFAIRS DIVISION

WHAT WE DO

- Monitor Listed Companies for compliance with SEC Rules and Regulations;
- Verify the accuracy of the notices/ announcements published by issuers and Listed Companies;
- Promote Corporate Governance Practices;
- Inquire into and resolve complaints of market intermediaries and investors;
- Monitor compliance with the Companies Take-overs and Mergers Code;
- Process and approve off-the-floor share transactions;
- Respond to surveys conducted by IOSCO; and
- Process and approve De-listing Applications.



From Left:
Julie Allegakoen, *Confidential Secretary*
Surana Fernando, *Director - Corporate Affairs*
Chamila Vithana, *Executive*

Due to a restructuring process, the work of the Corporate Affairs Division was assigned to other Divisions during the year. The Division was reconstituted in September 2005.

KEY ACTIVITIES

MONITOR LISTED COMPANIES FOR COMPLIANCE WITH SEC RULES AND REGULATIONS

All Listed Companies are required to submit Annual Reports within six months from the close of the financial year to their shareholders and the Colombo Stock Exchange. The audited accounts should be prepared and presented in accordance with the Sri Lanka Accounting Standards. The Annual Reports must comply with the relevant legal provisions.

During the period under review, the Division strengthened this process by referring some of the issues identified to the Sri Lanka Accounting and Auditing Standards Monitoring Board for technical advice. The review process will be further strengthened by entering into an agreement with the Sri Lanka Accounting and Auditing Standards Monitoring Board for regular review and reporting.

The objective of this exercise is to enhance the quality of information contained in these reports which has a direct impact on investor decision making and confidence placed in the Securities Market. These efforts also facilitated the Commission in researching the degree of comparability of financial statements produced by Listed Companies, in addition to timeliness and relevance of information contained in them.

PROMOTE CORPORATE GOVERNANCE PRACTICES

During the year under review, the SEC issued Guidelines for Listed Companies on Audit and Audit Committees, to be adopted on a voluntary basis.

The Institute of Chartered Accountants of Sri Lanka in association with SEC has developed a Code of Best Practice on Corporate Governance. Discussions are underway to mandate certain areas of this Code.

APPROVAL OF OFF-THE-FLOOR SHARE TRANSACTIONS

Approval was granted for 538 exceptional transfers and 280 gifting of shares during the year. The exceptional transfers were in order to facilitate margin trading, financial facilities, de-listing and restructuring of entities and portfolios, where beneficial ownership does not change.

HANDLING COMPLAINTS

The Division received 20 complaints during the year.

These complaints related to the following matters:

- Breach of CSE Listing Rules;
- Complaints regarding brokers;
- Unauthorized transactions;
- Non-receipt of rights/dividends/payments;
- Non-disclosure/non receipt of financial information;
- Issues related to registration of accounts on IPO's.



SURVEILLANCE AND RESEARCH DIVISION

WHAT WE DO

- Daily real-time monitoring of the trading activity to detect and prevent market abuse.
- Conduct preliminary examination into suspicious activities/price and volume movements in the securities market and violations of securities laws and regulations.
- Further examining the surveillance referrals of the Colombo Stock Exchange brought to our attention by the CSE from time to time.
- The Surveillance Unit also examines complaints made by investors or members of the general public and refers them to the Surveillance Committee.
- Preparation of reports on preliminary examination of detections of suspicious activity for submission to the Surveillance Committee.
- Scrutinize news sources such as press articles, corporate disclosures viz-a-viz market price behavior etc.
- Carry out specific research pertaining to the securities market, its development, international developments, best practices and trends in other markets etc.



From left:
 Manjula Chandraratne, *Executive*
 Chandu Epitawala, *Director, Surveillance and Research*
 D M G Priyantha, *Executive*

and examined these further. Reports on all these have been submitted to the Surveillance Committee for determination of whether a fully fledged investigation is to be undertaken.

The analysis of such detections in terms of broad categories of violations are listed below:

Nature of Surveillance	No. of issues
Price Manipulation/Front Running	8
Insider Dealing	12
Matters relating to Take-overs and Mergers	2
Others	4
Total	26

WHAT WE DID

Effective market surveillance ensures efficiency of a regulatory system. The Market Surveillance function of the SEC is considered important in achieving one of SEC's primary objectives of creating and maintaining a market in which securities can be issued and traded in an orderly and fair manner. The SEC believes that the fairness of the securities trading process and adequate investor protection are essential elements for a stable market.

The Division, based on a real time computer assisted surveillance system, monitored trading on the Colombo Stock Exchange in order to detect and prevent any untoward activities and irregularities in the market, as well as any possible breach of securities laws and regulations such as manipulation of share prices, insider trading etc. In addition, the Division also scrutinized various news sources such as press articles, corporate disclosures, market rumours etc. in relation to price movements in the market in order to collect information regarding the corporate activities / profiles of Listed Companies and their activities in the securities market.

Whenever any suspicious activity was detected, the Division gathered and analyzed all relevant information, conducted preliminary examinations and submitted reports based on the results of the preliminary examinations to the Surveillance Committee, which determines whether a fully fledged investigation into the matter is warranted.

During the year under review, the Division detected 26 cases of possible violations of provisions of the SEC Act,

WHAT WE PLAN TO DO

The Division is currently in the process of evaluating an enhanced information system (Reuters or Bloomberg) to augment the existing surveillance system of the SEC. The Division is also currently in the process of developing a new database of all active fund management companies, investment managers, listed companies etc. which would provide information on their directors, senior management, beneficial owners, and their relationships with other companies. This database will eventually be linked to the surveillance system of the SEC.

The Division is also considering the acquisition of a state of the art surveillance system, which will improve the effectiveness of the surveillance function of the SEC, which in turn contributes to increase the investor confidence in the Securities Market in Sri Lanka.

As a research undertaking, the Division plans to develop a resource center for data and information collected from overseas jurisdictions and securities markets pertaining to regulatory best practices, procedures, and policies.



INVESTIGATIONS DIVISION

WHAT WE DO

- Deal with complaints that appear to require the institution of legal or other proceedings, or the imposition of sanctions;
- Conduct investigations into fraudulent activities in the securities market and violations of securities laws and regulations;
- Conduct inquiries with regard to proposed take-overs and mergers where it is alleged that the mandatory offer provisions contained in the Take-overs & Mergers Code have been triggered;
- Conduct training programmes on securities related investigations; and
- Liaise with the institutions such as Colombo Stock Exchange, Attorney General's Department and Criminal Investigations Department in order to facilitate securities related matters/investigations.



From Left:
 Madhugayanie Balapitiya, *Senior Executive*
 Dhammika Perera, *Director Investigations*
 Shalini Perera, *Confidential Secretary*

WHAT WE DID

A total of 21 investigations were conducted by the Division in the year 2005, out of which 15 were completed during the year. The details and a brief description of the action taken/current status of the said investigations are given below:

NATURE OF INVESTIGATION	NO. OF INVESTIGATIONS	ACTION TAKEN/CURRENT STATUS
Insider Dealing¹	09	<ul style="list-style-type: none"> • Offence against one person was compounded in terms of Section 51A of the SEC Act for a total sum of Rs. 2 M. • Subsequent to detailed investigations, five investigations were terminated due to lack of evidence to establish charges of Insider Dealing. • As at 31st December 2005, two matters were pending with the Attorney General's Department for formal opinion. • One investigation was on-going as at 31 December 2005.
Market Manipulation²	05	<ul style="list-style-type: none"> • Offence against one person was compounded for a sum of Rs. 50,000/. • Offences with which two parties were charged with, were compounded upon payment by each of Rs. 3.3 million which sums were a remitted to the Compensation Fund. • A person charged with the offence requested that the offence be compounded upon payment of which the offence was to be compounded. However, due to the inability on his part to remit the compounding sum to the SEC it was decided to institute legal action against him.

Contd. on page 14



NATURE OF INVESTIGATION	NO. OF INVESTIGATIONS	ACTION TAKEN/CURRENT STATUS
		<ul style="list-style-type: none">• Subsequent to comprehensive investigations, two investigations were concluded due to lack of evidence to establish charges of Market/Price Manipulation.• Vide the advice received from the Attorney General's Department further investigations were conducted relating to another matter and the report relating to said further investigations was referred to the Attorney General's Department for formal advice.• At the end of the year 2005, investigations relating to two matters are in progress.
Complaints	04	<ul style="list-style-type: none">• Investigations commenced in respect of three matters and they were concluded as there was no evidence to prove any irregularity.• Deliberations relating to one complaint were suspended until the finality of on-going litigation since the issues pertaining to the said complaint form the subject matter pending before court.
Disclosure Requirements by a Listed Company	01	<ul style="list-style-type: none">• The investigation of the SEC was concluded during the year under review as the matters falls under the purview of the Registrar of companies for necessary action.
Forgery/Cheating	01	<ul style="list-style-type: none">• One investigation was on-going at the end of the year.
Alleged violation of the Take-overs and Mergers Code	01	<ul style="list-style-type: none">• This matter was concluded as there was no evidence to prove any irregularity.

It is of importance to note that the acquisition of vital investigative powers through the amendments to the SEC Act which came into force during the year 2003 have contributed immensely to facilitate conducting investigations in a more effective and expeditious manner.

1. Insider Dealing

Trading in the shares of a listed company whilst in the possession of unpublished price sensitive information in respect of the securities of the said Company.

2. Market Manipulation

Creation of a false or misleading appearance in respect of the trading, or the price of any securities listed on a stock market



LEGAL AND ENFORCEMENT DIVISION

WHAT WE DO

- Provide legal support and advice to the Commission and its various Divisions.
- Review, suggest and draft amendments to the Securities and Exchange Commission of Sri Lanka Act and subordinate legislation made thereunder.
- Review and approve rules and regulations of the Colombo Stock Exchange.
- Process and recommend applications for the grant and renewal of licenses to Stock Exchanges, Stock Brokers, Stock Dealers and Managing Companies of Unit Trusts.
- Process and recommend applications for the grant and renewal of registration to Underwriters, Margin Providers, Investment Managers, Credit Rating Agencies and Clearing Houses.
- Process and approve applications by foreign funds to invest in Companies in Sri Lanka.
- Facilitate the institution of legal proceedings and the prosecution of persons who contravene the provisions of the Securities and Exchange Commission of Sri Lanka Act, and subordinate legislation promulgated thereunder.
- Enforce compliance with legal requirements imposed on registered and licensed market participants by the Securities and Exchange Commission of Sri Lanka.
- Legal research to identify 'best practice' that may be adopted to support the development of the capital market.
- Respond to complaints made against market participants regulated by the Securities and Exchange Commission of Sri Lanka.



From Left:
Sharmila Panditaratne, *Executive*
Marina Fernando, *Director Legal and Enforcement*
Dayanthi Panabokke, *Executive*
Not in the picture:
Nihara Mallawa, *Executive*
Hasini Amaratunge, *Confidential Secretary*

WHAT WE DID

A. LITIGATION

CASES FILED BY THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA

1. Securities and Exchange Commission of Sri Lanka v. Magpek Exports Limited and its Directors

In terms of the Securities and Exchange Commission of Sri Lanka Act (as amended) the Securities and

Exchange Commission filed charges against Magpek Exports Limited and its Directors for failure to immediately disclose material information to the market and for the creation of a false market in respect of shares of Magpek Exports Limited.

Charges against three of the defendants were compounded in August 2001 on an application made in that respect.

Trial against the remaining defendants is continuing in the Magistrate's Court, Fort as at 31st December 2005.

2. Securities and Exchange Commission of Sri Lanka v. H. Gamini Fonseka

The Securities and Exchange Commission of Sri Lanka filed charges in the Magistrate's Court, Fort against Mr. H. Gamini Fonseka for violating the provisions contained in the Take-overs and Mergers Code 1995. Having made a mandatory offer to the shareholders of Kapila Heavy Equipments Limited (KHEL), Mr. Fonseka failed to make payment to some of the shareholders of KHEL who had accepted his offer to buy their shares.

According to a request made by Mr. Fonseka, the Securities and Exchange Commission of Sri Lanka decided that the offence may be compounded at Rs. 3.3 million, provided Mr. Fonseka settled all



outstanding payments. The amount for which the offence was compounded is the maximum levy permissible under the Securities and Exchange Commission of Sri Lanka Act.

Mr. Fonseka settled all payments outstanding to shareholders by the end of August 2005. The payments made relate to the purchase price for shares agreed to be purchased by Mr. Fonseka subject to interest at the rate of 24% per annum.

B. REGULATION

TAKE-OVERS AND MERGERS CODE

- Pursuant to the constitution of a Committee in September 2003, the Securities and Exchange Commission of Sri Lanka is continuing with the revision of the Take-overs and Mergers Code 1995 in consultation with the Stakeholder Committee.
- The revision has been undertaken with the objective of clarifying the scope of application of the Code and to take account of the emerging needs of the capital market. Regulation in the UK and of emerging markets in Asia have also been considered in this exercise.

CORPORATE GOVERNANCE

Pursuant to an initiative by the Institute of Chartered Accountants of Sri Lanka (ICASL) and the Securities and Exchange Commission of Sri Lanka, a Committee has been appointed to formulate rules on Corporate Governance in order that it may be mandated through the Listing Rules of the Colombo Stock Exchange.

The Committee decided to develop standards pertaining to:

- the role of independent non-executive directors
- promoting independence of decision making
- disclosure by new directors
- remuneration committees
- audit committees

The Committee has had several meetings in this regard, and a preliminary draft of the rules is presently under consideration and revision.

SECURITIZATION

The Securities and Exchange Commission of Sri Lanka has been designated by the Ministry of Finance to

facilitate the drafting of a securitization law with a view to developing the capital market in Sri Lanka.

Securitization is utilized as an alternate mechanism to facilitate financing. The draft law will take account of the necessity to regulate the structuring of securitized instruments and the mobilization of funds from the public domain.

A diagnostic study is presently underway in consultation with industry stakeholders. The study will identify the specific needs of the market, the strengths and weaknesses of the regulatory framework subsisting in Sri Lanka and the options available to Sri Lanka in developing securitization.

C. REGULATION FOR INVESTMENT MANAGERS, MARGIN PROVIDERS, CREDIT RATING AGENCIES, UNDERWRITERS AND CLEARING HOUSES

Subsisting standards subject to which the five classes of Market Intermediaries are registered were reviewed and a revision thereof commenced with the ultimate objective of securing better risk management within each industry. The Securities and Exchange Commission of Sri Lanka has worked in consultation with the industry in this respect.

D. COUNTRY AND REGIONAL FUNDS

The Securities and Exchange Commission of Sri Lanka granted approval in terms of the Gazette Extraordinary No.720/12 of 24th June 1992 to 59 Country and Regional Funds to invest in companies in Sri Lanka.

E. REGISTRATION AND LICENSING OF MARKET PARTICIPANTS

The under-mentioned market participants were registered/licensed

(i) Market Intermediaries

- 2 Credit Rating Agencies
- 6 Investment Managers
- 14 Margin Providers
- 4 Underwriters
- 1 Clearing House

(ii) Stock Brokers and Stock Dealers

- 15 Stock Brokers
- 4 Stock Dealers



(iii) Unit Trusts

The Securities and Exchange Commission of Sri Lanka granted a licence to National Asset Management Company Limited to operate the first closed end unit trust, namely NAMAL Flexi Income Fund.

Reviewed subsisting exposure limits imposed on investments made by unit funds and commenced work in consultation with the industry in revising the standards which took account of the development in the market. The subsisting standards were developed in 1992.

F. MATTERS RELATING TO THE INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS (IOSCO)

The Securities and Exchange Commission of Sri Lanka with the assistance of the IOSCO Assessment Team identified steps required to be taken by the Securities and Exchange Commission of Sri Lanka in becoming fully compliant with the IOSCO Objectives and Principles. These Principles have been adopted at the IOSCO's Annual Conference in September 1998 and are one of twelve standards and codes highlighted by the Financial Stability Forum as key to sound financial systems and deserving priority implementation.

The Principles set out a broad framework for the regulation of securities, including the regulation of:

1. Securities Markets
2. The intermediaries that operate in those markets
3. The issuers of securities
4. The sale of interest in and the management and operation of Collective Investment Schemes

The Securities and Exchange Commission of Sri Lanka was rated 'Partly Compliant' with the requisite standards. Measures are currently underway to facilitate compliance authorised to the extent possible by taking account of the authorised scope of the Securities and Exchange Commission of Sri Lanka and budgetary constraints on the Securities and Exchange Commission of Sri Lanka.



SUPERVISION DIVISION

CORE FUNCTIONS

- Monitor the financial stability and operational procedures of licensed Stock Brokers/Dealers and Unit Trust Management Companies by conducting on-site and off-site inspections of Stock Broking Firms and Unit Trust Management Companies so as to ensure that adequate capital is maintained and that these companies are financially stable.
- Examine financial statements forwarded by Stock Broking Firms for renewal of their licence, and to ensure compliance with SEC and CSE requirements.
- Evaluate and monitor the financial stability and operational procedure of Market Intermediaries (Underwriters, Margin Providers, Investment Managers, Credit Rating Agencies and Clearing Houses) for registration and renewal of their licenses, and to ensure compliance with SEC requirements.
- Ensure that laws and regulations of the SEC are duly complied with by Stock Broking/Dealing Firms and Management Companies of Unit Trusts.
- Verify the accuracy and approve the announcements/press releases/interim reports published by Unit Trust Management Companies.
- Respond to surveys conducted by IOSCO



From Left:
Saumi Kodippily, *Executive*
Harshana Wanniarachchi, *Officer*
Himani Weerasekera, *Senior Executive*
Viraj Rajapakse, *Executive*
Chamarie Ekanayake, *Senior Executive*
Dinesha Perera, *Executive*

WHAT WE DID

BROKING COMPANIES

Supervision of Stock Broking Companies

The SEC Act requires all Stock Broking Firms to obtain an annual licence and to be members of a licensed Stock Exchange. The licence is granted by assessing the financial position of the firm. In addition, on-site supervision is conducted annually to determine the financial stability of the Stock Broking Firms. During the year 2005, there were fifteen Stock Dealing and Broking Firms.

In order to monitor the financial stability and operational procedures of licensed Stock Broking Firms, the SEC has stipulated that the Stock Broking Firms maintain a minimum net capital requirement¹ which was subsequently increased from Rs. 11 Million to Rs. 15 Million effective from 31 December 2005. In the fiscal year 2005, non-compliance by one firm resulted in immediate action being taken to correct the net capital position. In addition to the

minimum net capital requirement, Stock Broking Firms are required to adhere to specified liquidity requirements, appoint competent compliance officers capable of overseeing regulatory compliance procedures and maintain separate client accounts. Further, they are required to follow an established Central Order Desk (COD) procedure pertaining to the receipt, execution, and allocation of orders, which will only be verified if an investor lodged a complaint.

The Stock Broking Firms are required to submit monthly unaudited accounts and compliance reports to the Commission. The compliance reports are reviewed by the officers of the Supervision Division to ensure that the compliance procedures are adhered to, whilst the monthly unaudited accounts are analyzed to ensure that the Stock Broking Firms are financially stable.

The supervision staff monitor the Stock Broking Firms off-site by reviewing the returns and documents submitted viz., monthly unaudited accounts, net capital statements, debtors and creditors age analysis and the liquidity position to assess the financial stability of the Stock Broking Firms. Further, the Division reviewed the compliance reports to ensure that the firms complied with the compliance procedures set out by the CSE. The supervision staff visited the fifteen Stock Broking Firms during the year to ensure that the companies complied with the SEC Act, rules of

¹ A minimum net capital requirement is defined as shareholders' funds adjusted by all unsecured amounts.

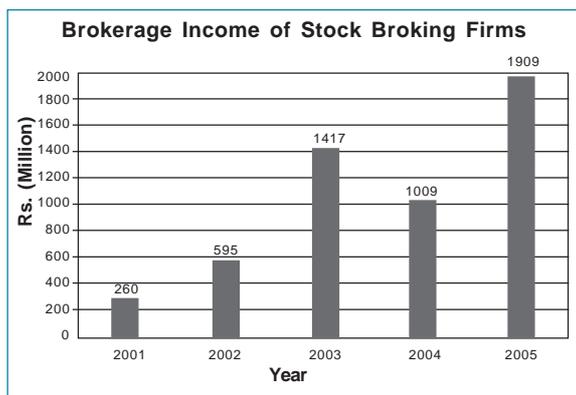


the CSE and emphasis was also placed on strengthening internal control systems. Compliance with the aforesaid requirements by these companies was found to be satisfactory, except for a few companies where minor discrepancies/non – compliance were observed.

Performance of the Stock Broking Firms

The overall brokerage income earned by Broking Firms during the year was Rs. 1.9 Bn (approx.), an increase of Rs. 900 Mn (approx.) compared to the year 2004. The main reason for the increased brokerage income was due to enhanced investor confidence in the market, which in turn raised market prices and increased the turnover. This was evident with both All Share Price Index (ASPI) and the Milanka Price Index (MPI) recording an all time high on 16 November 2005.

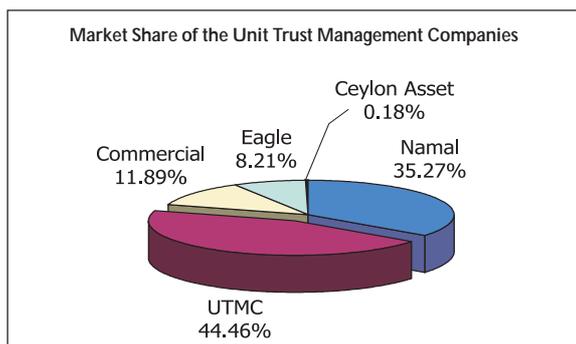
The following graph depicts the Brokerage Income of Stock Broking Firms during the period 2001-2005:



UNIT TRUST FUNDS

There were thirteen Unit Trust Funds managed by five Management Companies as at 31 December 2005.

The market share of each Unit Trust Management Company as at 31 December 2005 is reflected in the following chart:



Supervision of Unit Trust Management Companies

The Supervision Division visited two Management Companies during the year under review. The inspections were carried out in accordance with the Audit Programme developed by the Supervision Division of the SEC in order to verify whether the investment parameters for Unit Trust Funds were maintained as set out in the Unit Trust Code and relevant Trust Deeds. The inspections were also undertaken to ensure strict compliance with operational procedures and the financial stability of the companies concerned.

A Management Company that was found to have fallen below the minimum net capital requirement during the latter part of 2004, was provided time to correct this position by infusing the capital to meet the net capital requirement. Since the Company had not infused the said capital as at 31 December 2004, the Secretariat decided to provide time to infuse the required capital in installments over a period of time. This position was corrected during the latter part of 2005.

The Supervision Staff reviewed the monthly accounts and returns submitted to the Commission in respect of the thirteen Unit Trust Funds. In addition, the Supervision Staff also monitored the exposure levels of the Unit Trusts according to the investment limitations set out in the relevant Trust Deeds and the Unit Trust Code. The Companies were found to be within acceptable limits. The Management Companies concerned corrected the exposure that exceeded the limits.

In addition, the Division approved press releases, interim reports and annual financial statements of Unit Trust Funds. The documents submitted were reviewed and the Division recommended necessary amendments.

Performance of the Unit Trusts

The Unit Trust Industry recorded a positive growth of 8% in terms of the fund value and 2% in units issued, whilst unit holders recorded a positive growth of 0.02% when compared to the previous year.

At the end of year 2005, thirteen unit trust funds recorded 345 million units in circulation compared to 340 million during 2004. The number of unit holders had increased from 23,650 as at 31 December 2004 to 23,654 as at 31 December 2005. The overall Net Asset Value of funds increased by Rs. 338 million (approx.) from Rs. 4.2 billion (approx.) as at 31 December 2004 to Rs. 4.5 billion (approx.) as at 31 December 2005. The main reasons for the increase in the Net Asset Value was due to increase in the Net Asset Value of Balanced Funds and General



Purpose Funds which invests heavily in the Stock Market. This was in line with the increase in the All Share Price Index by 27.56%.

It was also observed that on average, approximately 66% of the deposited property of Unit Trusts was invested in the equity market, and 30% of their funds in Treasury Bills, whilst 4% was invested in other money market instruments.

Supervision of Market Intermediaries

The SEC Act empowers the SEC to grant a certificate of registration to a person to carry out business as a market intermediary and to ensure the proper conduct of such business.

The Supervision Division was involved in ascertaining the financial stability of the Market Intermediaries in granting registration and renewing licenses to those entities. The Supervision Division reviewed the Audited Accounts and where necessary, the interim statements were also reviewed to determine the financial stability of the market intermediaries.

There were a few Market Intermediaries that did not meet the required minimum capital requirement and were informed to infuse the shortfall. The licenses were renewed, subsequent to the infusion of capital.

The Overall Position Of Unit Trust Funds As At 31 December 2004 and 31 December 2005

	31/12/05	31/12/04	Inc./ (Dec.)
Net Asset Value (NAV) (Rs. Mn.)	4,495	4,158	8.1%
No. of Unit Holders	23,654	23,650	0.02%
No. of Units Issued ('000)	345,528	339,871	1.66%
Investment in Equity (Rs. Mn)	2,983	2,905	2.68%
Investment in Treasury Bills (Rs. Mn)	1,327	1,182	12.3%
Investment in other Instruments (Rs. Mn)*	185	71	160%
ASPI	1,922.21	1,506.89	27.56%
MPI	2,451.06	2,073.74	18.19%

* (E.g. Commercial Papers, Promissory Notes, Debentures and Bank Deposits)



PUBLIC RELATIONS & MARKET DEVELOPMENT DIVISION

WHAT WE DO

- Monitor compliance with the Companies' Take-overs and Mergers Code 1995;
- Respond to surveys conducted by IOSCO;
- Process and approve De-listing Applications;
- Handle international relations;
- Coordinate publications;
- Develop and conduct training programmes on Capital Market, Securities Law and related subjects;
- Conduct training programmes for SEC staff; and
- Co-ordinate the development of the SEC library.



From Left:
 Krishanthi Muthuthanthrige, *Confidential Secretary*
 Malik Cader, *Director, Public Relations & Market Development*
 Suneth Perera, *Senior Executive*
 Kumari Siriwardena, *Confidential Secretary*

WHAT WE DID

Take-overs and Mergers

During the year under review the following Take-overs were regulated by the division

Other issues in relation to Take-overs and Mergers:

The Division analyzed the implications of the Take-overs and Mergers Code in relation to Indirect Take-overs, directors crossing the threshold of the same company, mergers between two Banks, how shareholder's activities (voting in meetings) would be taken into account when interpreting "acting in concert", and crossing the threshold limit when subscribing to rights etc. During the year under review one request was made in terms of Rule 31(1A)(2) of the Take-overs and Mergers Code requesting permission from the Commission to divest the holding below the threshold limit.

APPROVAL UNDER SECTION 28A OF THE SEC ACT

In terms of Section 28A of the SEC Act, if a Public Company wishes to allot shares or any securities convertible to shares to any person prior to its listing on the Stock

Exchange with the intention of obtaining a listing within a period of one year of such allotment, prior approval of the SEC is required.

The rationale for this requirement is to avoid a situation where a Company could place shares at a discount to the public issue price with selected individuals and institutions prior to obtaining a listing on the Stock Exchange, and subsequently trade in the market at an undue price advantage.

In terms of the said Section, the following applications were reviewed by the Division.

Vidullanka (Pvt) Ltd	12,000,000 ordinary shares prior to a listing	Approved
Vallibel Power Erathna Ltd	allot 14,715,342 Ordinary Shares prior to a listing	Approved
Vanik Leasing Ltd	542,123 fully paid shares as bonus	Application withdrawn
Vanik Factors Ltd	483,058 fully paid shares as bonus	Application withdrawn

OFFEROR	OFFEREE	TYPE
Mr Rusi Sohli Captain	Chemical Industries Colombo (Ltd)	Voluntary
Curlew Private Limited (Curlew)	Hotels Corporation Limited	Mandatory
Axis Financial Services (Pvt.) Ltd	Asian Cotton Mills (Ltd)	Mandatory

**APPROVAL UNDER SECTION 29A OF THE SEC ACT**

In terms of Section 29A of the Securities and Exchange Commission Act as amended, no Listed Public Company or any Public Company, which has applied to obtain a listing in a licensed stock exchange, can make any issue of securities unless the issue has been approved by the Commission, or any person authorized in that behalf by the Commission. For the purposes of this section, “issue of securities” means:

- (a) in relation to a Public Company which has applied to obtain a listing, an introduction, an offer for subscription, an offer for sale or any placement of securities on a stock exchange;
- (b) in relation to a listed Public Company:
- (i) New issues, or offer for sale of securities to the public, whether such issues or offers for sale are by way of public issue or otherwise, or any placement of securities;
 - (ii) Rights Issues of Securities;
 - (iii) Bonus Issues of Securities;
 - (iv) Schemes of arrangements, schemes or reconstruction, take-over, share option and acquisition of assets by way of issues of securities.

During the year under review, the following applications were reviewed by the Division:

Company	Type of the Issue	
Lankem Ceylon Ltd	18 Million preference shares	Approved
MGT Knitting Mills Ltd	4,276,304 fully paid convertible shares	Approved
Overseas Reality Ltd		
Singer Sri Lanka Ltd	500 Million unquoted, redeemable unsecured rated debentures	Approved
Singer Sri Lanka Ltd	400 Million unquoted, redeemable	Approved
Seylan Merchant Bank Ltd	400 million debentures	Approved
Seylan Merchant Bank Ltd	200 Million debentures	Approved
Commercial Bank Ltd	1 Billion debentures	Approved
Ceylinco Securities and Financial Services Ltd	300 Million debentures	Approved

Delisting

Approval was granted to de-list the ordinary shares of the following Companies:

1. Ceylon Holiday Resorts Limited
2. Habarana Lodge Limited
3. International Tourists and Hoteliers Limited Kandy Walk Inn Limited
4. Lakdhanavi Limited

Other issues

The following waivers were granted in terms of the CSE Listing Rules.

- Approval was granted in terms of Rule 3.2(iii) of the CSE Listing Rules to Sampath Bank Limited (Rights Issues) to waive Rule 3.7(iii) of the said Rules.
- In terms of Rule 4.24 of the CSE Listing Rules, approval was granted to waive Rules 4.11-1, 4.19, 4.21, 4.22-2 and 4.22 of the said Listing Rules for HNB, GDR issue.
- Approval was granted in terms of Rule 3.2(iii) of the CSE Listing Rules to Asiri Hospitals Limited (Rights Issues) to waive Rule 3.7(iii) of the said Rules.
- Approval was granted in terms of Rule 3.2(iii) of the CSE Listing Rules pertaining to Ceylon Investment Company Limited and Ceylon Guardian Investment Trust Limited (Bonus Issues) to waive off Rule 3.6(c) of the said Rules.



INTERNATIONAL RELATIONS

International Organization of Securities Commissions (IOSCO) Annual Conference, 4 – 7 April 2005

The 30th Annual Conference of the International Organization of Securities Commissions (IOSCO) was held from 4th – 7th April 2005 at the BMICH. A total of 419 participants including Ordinary, Affiliate, Associate Members, Observers, Interpreters and IOSCO staff attended the four day conference in Colombo. The Hon. Minister of Finance, Dr. Sarath Amunugama graced the Opening Ceremony, which was held on the 6th April 2005. Programmes were arranged for the accompanying guests on each day of the Conference.

A Study Tour for the Officials of the Securities Industry

A visit was arranged for a delegation of senior officials from the SEC, Colombo Stock Exchange and Stock Broking Companies to visit Thailand in June 2005. The delegation visited the Thai SEC, Stock Exchange and a Securities Company.

CSE Road Show in Australia and New Zealand

A delegation from the SEC participated at the CSE Road Show held in Australia and New Zealand in October 2005.

Programme on Debt Market of Sri Lanka

The SEC arranged a four day orientation programme on the Debt Market of Sri Lanka for a delegation from the SEC Bangladesh, Bangladesh Bank and the Ministry of Finance in June 2005.

IOSCO related work

- Ghana's application to IOSCO to become a signatory to the IOSCO MMOU was perused and observations were made thereon.
- Responded to questionnaires received from IOSCO in relation to "Internal Controls" and "Collective Investment Schemes".

TRAINING

Teacher Training on Capital Markets

The SEC continued to conduct programmes in association with the National Institute of Education (NIE) to educate regional master teachers, resource teachers and Additional Directors of Education on the subject of Capital Markets and current developments. Three comprehensive three day residential training programmes in Sinhala and Tamil provided an opportunity for the participants to update their knowledge on the Capital Market. These programmes

were held at the NIE auditorium, Maharagama, with field visits to the Colombo Stock Exchange and the SEC.

The subject of Capital Markets was introduced into the GCE (Advanced Level) curriculum in the early 1990's, and around 60,000 students annually offer the subject at the examination. Commencing December 2001, the subject of Capital Markets has also been included in the Ordinary Level Curriculum, thus exposing over 100,000 students to the subject.

Workshop on Capital Markets for University Academics

A two day work shop on Capital Markets was arranged for the University Academics in June 2005. The division invited all Universities in Sri Lanka to nominate representatives to attend the workshop which covered areas such as Investment Banking and Treasury Management, Unit Trust Industry in Sri Lanka and recent developments, Financial Reporting and Corporate Governance in Sri Lanka and Overview of the SEC and Offences under the SEC Act. A visit to the Colombo Stock Exchange was also included in to the programme to provide practical experience to the participants.

Workshop on Capital Market Reforms

The SEC in association with the National Council for Economic Development (NCED), organized a workshop on "Capital Market Reforms" in September 2005. Seventy five participants representing the SEC, CSE, Milanka Companies, Stock Brokers and Unit Trust Industry attended the workshop. The Secretary to the Treasury, Dr P B Jayasundara, delivered the keynote address.

Programme on Financial Crime and Investigation

A four-day workshop on Financial Crime and Investigation was held in July 2005. Forty-eight participants including eight participants from Asia Pacific Regional Committee (APRC) countries attended the programme. Prof. Barry Rider of Beachcroft Wansbroughs' International Integrity Services, UK conducted the workshop.

Survey on Audit Committees of Listed Companies

On the instructions of Mr. Udayasri Kariyawasam, Commission Member, SEC, the Division coordinated a survey and published a report on "Audit Committees of Listed Companies" of the Colombo Stock Exchange.

Consultancy to Develop the Corporate Debt Market in Sri Lanka

Considering the thin growth of the Corporate Debt Market in Sri Lanka, in contrast to Equity Market, the SEC



obtained the services of a consultant to explore the reasons for the failure of the debt market and identify measures to develop a vibrant debt market in Sri Lanka. The Division handled all activities relating to the selection of the consultant.

“Rajarata Aruna” Trade Exhibition

On a request made by the Prime Minister’s Office, the SEC participated in the “Rajarata Aruna” Trade Exhibition in July 2005 in Anuradhapura. The Colombo Stock Exchange also participated at the Exhibition.

Other Seminars and Programmes

The SEC conducted several seminars for the following Institutions and Associations:

- Seminar on Capital Markets for the Deputy Directors and Assistant Directors of Education in the Commerce stream at the Ministry of Education, Isurupaya, Battaramulla.
- Programme on Capital Markets for the investors, potential investors and entrepreneurs in Kandy.
- Presentation on the “Role and Functions of the SEC” for Junior Command and Staff College, Sri Lanka Air Force.
- Seminar on Capital Markets for the Members of the Chamber of Commerce, Kegalle.
- Programme on the “Benefits of Investing in the Stock Market” for the entrepreneurs of the Sabaragamuwa Chamber of Commerce and Industry, Ratnapura.
- Seminar on “The Potential of the Colombo Stock Market” for the Members of the Matara Clinical Society, Matara.
- Seminar on the Capital Markets for the members of the Kurunegala Clinical Society, Kurunegala.
- Workshops on the Capital Market for the undergraduates of the Universities of Peradeniya and Ruhuna.
- Programme on the Capital Market at the Peradeniya Central College, Peradeniya.

The SEC continued to conduct in-house training programmes for the benefit of the staff on technical issues and subjects of general interest. Among the subjects covered were:

- Enterprise Governance
- Mergers, De-Mergers and Issues relating to American Depository Receipts.
- Share Valuation
- Unit Trust Industry in Sri Lanka
- Securitisation
- Rating Methodology and Rating Scales

A residential training programme was held for the SEC staff in August. Mr. Dhammika Kalapuge, Chartered Marketer, conducted the programme.

PUBLICATIONS

- Completed the fourth edition of the Sinhala publication on the Securities Market of Sri Lanka authored by Prof. Lalith Samarakoon. The booklet is used as a textbook on the Securities Industry of Sri Lanka by students, teachers, researchers and other interested parties in the country.
- The 2004 Annual Report of the Securities and Exchange Commission of Sri Lanka was published in English during the period under review.

Library Development

The SEC is continuing its library development programme by adding more books to the library. The library now has one thousand seven hundred and sixteen books.



FINANCE AND ADMINISTRATION DIVISION



Front Row from Left

Lakshmi Wickramanayake, *Officer*
 Dhanesha Rajapura, *Confidential Secretary*
 Ashoka Dayaratne, *Officer*
 Ianthie Jayaratne, *Director Finance and Administration*
 Rupika Bandara, *Executive*
 A G Inoka Priyanganie, *Receptionist cum Telephone Operator*
 Ranmini Jayatilleke, *Executive-Information Systems*

Back Row from Left

M Jayasekera, *Driver*
 Anura Perera, *Driver*
 Pathum Niroshana, *Office Aide*
 S D Dharmasiri, *Driver*
 A C Dias, *Officer*
 W Ariyaratne, *Driver*
 Chandran Nagendran, *Office Aide*

WHAT WE DO

- Financial control and budgeting including preparation of monthly, quarterly and annual accounts.
- Manage the Cess Fund, Compensation Fund and Settlement Guarantee Fund
- Personnel Management
- Develop and manage SEC's Information Technology infrastructure
- Supervise general maintenance and upkeep of the Secretariat
- Procurement of supplies

Post	Approved Cadre	In Employment
Director General	01	01
Directors	08	06
Executives	22	21
Staff	17	11
Office Aide	07	07
Total	55	46

As at 31st December 2005 the SEC had 46 staff members that served the Commission consisting of 15 males and 31 females.

WHAT WE DID

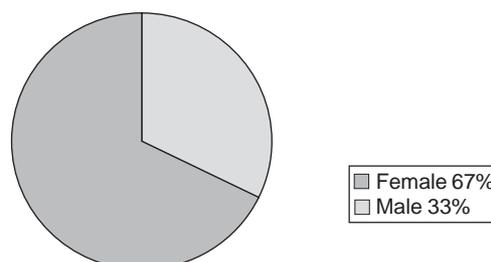
STAFFING

From the inception of the SEC, emphasis has been placed to engage appropriately qualified personnel with recognized experience to the Commission. Accordingly six appointments were made during the year under review of the Director General, Director Corporate Affairs, Director Surveillance & Research, Director Supervision and two Executives.

The approved cadre and the human resource strength of the Secretariat as at 31.12 2005 are depicted below.

The gender, age and service analysis of the staff of the SEC are depicted as follows.

Gender Analysis





Service Information

Period of Service	Number of years of service at SEC expressed as a percentage
Less than 5 years	37%
More than five years but less than 10 years	39%
More than 10 years	24%

Age Analysis

Age Group	Number of Employees falling within the age group expressed as a percentage
25-35 Years	54%
36-45 Years	33%
46- 55 Years	13%

TRAINING

The Secretariat continued to place emphasis on the development of technical skills of the staff of the SEC in their relevant fields to discharge the mandate entrusted to the Commission effectively and efficiently. The foreign training provided during the year covered areas such as Economic Crime, Securities Market Regulation, How to Fight Corporate Fraud, Derivatives etc. Local training was provided to all levels of staff that included a residential programme on 'A Formula of Success' to the SEC staff. The total cost incurred on local and foreign training for the staff of the SEC during the year under review amounted to Rs. 5.5 Million.

STAFF WELFARE

Secretariat offers its staff a range of benefits such as indoor and outdoor medical schemes, personal accident insurance cover, vehicle and distress loan schemes, festival advance, educational grants and reimbursement of membership fees to professional bodies etc.

The Secretariat provides an opportunity to enhance the relationships with staff and their families by organizing an Annual Sports Day, Residential Training Programme and a Christmas party.

INFORMATION TECHNOLOGY

The Division organized and coordinated the Information Technology requirements of the 30th IOSCO Annual Conference which was held in Colombo from the 4-7 April 2005.

The Division administered the IOSCO Conference website, SEC website and Local Area Network system in an efficient and effective manner.

CESS FUND

Sections 14A and 14B of the SEC Act, No 36 of 1987 as amended by Act, No. 26 of 1991 and Act, No. 18 of 2003 states as follows:

14A (1) There shall be charged, levied and paid a Cess at such rates as may be specified by the Minister by Order published in the Gazette on every purchase and sale of securities recorded in a licensed stock exchange or notified to it under its rules by both the purchaser and the seller. Different rates may be specified in respect of different classes of securities.

(2) The Cess imposed under this section shall be in addition to any other tax or Cess levied under any other written law.

14B(1) There shall be established a fund called the Cess Fund to which shall be credited the proceeds of the Cess imposed under section 14A.

(2) There shall be paid out the Cess Fund such sums as may be authorized by the Commission for the purpose of-

- (a) developing the securities market;
- (b) enhancing monies lying to the credit of the Compensation Fund established under Section 38; and
- (c) exercising, performing and discharging the powers, duties and functions of the Commission for the purpose of achieving its objects.

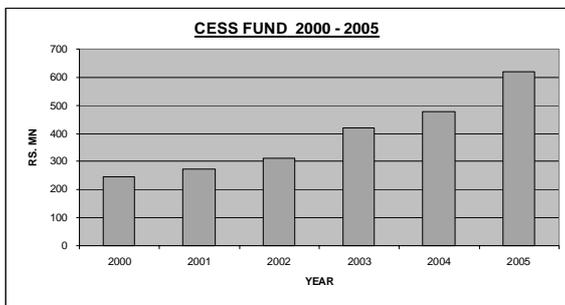
(3) The money lying to the credit of the Cess Fund may be invested by the Commission in such manner as may be determined by the Commission.

The rate of Cess charged by the SEC was reduced from 0.1% to 0.09% per transaction with effect from 1.12.03.

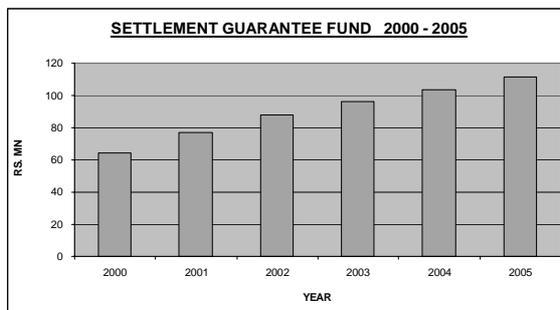
The balance lying to the credit of the Cess Fund as at 31.12.2005 amounted to Rs 618 million.



The growth of the fund during the period 2000-2005 is depicted below:



The growth of the Fund between 2000 and 2005 is depicted in the following graph.



THE SETTLEMENT GUARANTEE FUND (SGF)

The SGF was launched on 22 May 1998. The Fund was established for the purpose of guaranteeing the settlement of trades between participants of the Central Depository System of the Colombo Stock Exchange (CSE).

The operation of the SGF is described below.

- The settlement cycle presently followed in CSE is of a two-tiered nature.

Ownership of shares traded is transferred no sooner a trade is executed. With effect from 3rd October 2005 the settlement cycle for equity transactions were reduced. Accordingly the buyer is required to pay on T+3 i.e. on the 4th market day including the day of trading and the seller to settle on T+ 4 i.e. the 5th market day including the day of trading. This relatively long interval between transfer of ownership and receipt of proceeds that gave rise to an unsecured settlement risk necessitated the establishment of SGF.

- The Trustees of the Fund hold office of ex-officio and comprise with the Chairman of SEC, the Chairman of CSE, the Deputy Secretary to the Treasury, the Director General of SEC and the Director General of CSE.
- The Government of Sri Lanka has contributed a sum of Rs 50 million to the said Fund. This money has been invested in Government securities in terms of the Trust Deed. SGF can also receive donations, gifts and endowments as replenishments. The broker/custodian banks are presently not required to contribute to the Fund.
- The balance lying to the credit of the fund as at 31.12.2005 amounted to Rs 111 million.

COMPENSATION FUND

The Compensation Fund came into operation along with the establishment of the SEC in 1987. Section 38 of the Securities and Exchange Commission Act No 36 of 1987 as amended states as follows:

- There shall be established a fund called the Compensation Fund, for the purpose of granting compensation to any investor who suffers pecuniary loss as a result of any licensed stock broker or licensed stock dealer being found incapable of meeting his contractual obligations.
- The Compensation Fund shall consist of
 - such sums of money as may be voted upon by Parliament for the purpose of the Fund;
 - such sums of moneys may be credited to the Fund under Section 51A; (Section 51A is on compounding offences);
 - such sums of money as may be credited from Cess Fund under section 14B.
- Moneys belonging to the Compensation Fund may be invested by the Commission in such manner as may be determined by the Commission.

The Minister shall appoint from among the Members of the Commission three members who shall comprise the Compensation Committee.

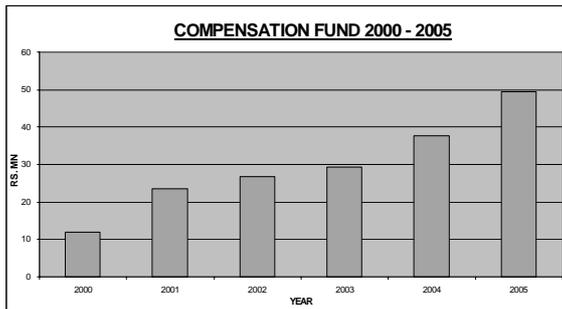
The Committee shall be responsible for assessing and awarding compensation in respect of any application made and the decision of such Committee on any such assessment or award shall be final and conclusive for the purpose of this Act.



The Act also provides for the procedure for applying for compensation. According to the Act, the Committee may, after examination of the documents and other evidence produced in support of the claim by an applicant, or in any case where an inquiry was held on the conclusion of such inquiry, allow or disallow such claim for compensation. Up-to-date there have been no claims made from the Compensation Fund.

The balance lying to the credit of the Compensation Fund as at 31.12.2005 amounted to Rs. 49 million including Rs. 8,650,000.00 received for compounding offences pertaining to market/price manipulation and insider dealing during the year under review.

The growth of the Fund during the period 2000 to 2005 is depicted below:





CALENDER OF EVENTS FOR 2005

MARCH

A Discussion with the academics of all universities in Sri Lanka on the subjects of Capital Markets and Insurance.

A three-day Residential Training Programme for Master Teachers and Resource Teachers in Sinhala at the National Institute of Education, Maharagama.

APRIL

30th Annual Conference of the International Organization of Securities Commissions (IOSCO) at the BMICH.

A three-day Residential Training Programme for Master Teachers and Resource Teachers in Tamil at the National Institute of Education, Maharagama.

Seminar on Capital Markets for the Deputy Directors and Assistant Directors of Education in the Commerce stream at the Ministry of Education, Isurupaya, Battaramulla.

MAY

Seminars on Capital Markets for the students of the Moneragala Educational Division and Entrepreneurs of the Moneragala District.

Presentation on Capital Markets for the students of the Galigamuwa educational division at the Mahapola Exhibition held at the Galigamuwa Maha Vidyalaya, Galigamuwa.

JUNE

A two-day workshop on Capital Markets for the university academics at the SEC.

A programme on "Debt Market of Sri Lanka" for a delegation from the SEC, Bangladesh, Bangladesh Bank and the Ministry of Finance.

JULY

A programme on "Financial Crime and Investigations" conducted by Prof. Barry Rider of Beachcroft Wansbroughs' International Integrity Services, UK, at the Hilton, Colombo.

Seminar on Capital Markets for the investors, potential investors and entrepreneurs in Kandy.

A presentation on Capital Markets for the students of the Peradeniya Central College, Peradeniya.

Promotion of the Capital Market at the "Rajarata Aruna" Trade Exhibition in Anuradhapura.

AUGUST

Staff Residential Training Programme in Kalutara.

Presentation to the SEC staff on "Mergers, De-Mergers and Issues relating to American Depository Receipts (ADR's).

SEPTEMBER

SEC/National Council for Economic Development (NCED) workshop on "Capital Market Reforms" at the "Holiday Inn" Colombo.

Seminar on the "Role and Functions of the SEC" for the officers at the Junior Command and Staff College, Sri Lanka Air Force.

Presentations to the SEC staff on:

- Enterprise Governance
- Share Valuation
- Unit Trust Industry in Sri Lanka

OCTOBER

CSE Road Show in Australia and New Zealand. A delegation from the SEC participated at the Road Show.

A three-day Residential Training Programme for Master Teachers and Resource Teachers in Tamil at the National Institute of Education, Maharagama.

Seminar on Capital Markets for the Members of the Chamber of Commerce, Kegalle.

A Workshop on Capital Markets for the undergraduates of the University of Peradeniya.

Seminar on Capital Markets for the entrepreneurs of the Sabaragamuwa Chamber of Commerce and Industry in Ratnapura.

Presentations to the SEC staff on:

- Securitisation
- Rating Methodology and Rating Scales

NOVEMBER

Seminar on the "Potential of the Colombo Stock Market" for the Members of the Matara Clinical Society, Matara.

Seminar on Capital Markets for Members of the Kurunegala Clinical Society, Kurunegala.

A workshop on Capital Markets for the undergraduates of the University of Ruhuna.



FINANCIAL REPORTS >>>



BALANCE SHEET

As at 31st December	Notes	2005 Rs.	2004 Rs.
ASSETS			
NON CURRENT ASSETS			
Property Plant & Equipment	1	24,093,739	18,224,014
Cess Fund Investment & Others	2	618,594,288	478,478,518
Compensation Fund Investment & Others	3	49,459,089	37,642,655
CURRENT ASSETS			
Inventories	4	399,504	381,453
Stamps		1,284	24,869
Receivables	5	854,585	742,753
Deposits, Advance and Prepayments	6	933,935	1,832,973
Repo Investments - Life Insurance Payable	7	5,636,627	-
Cash	8	7,042,966	101,233
TOTAL ASSETS		707,016,017	537,428,468
FUNDS AND LIABILITIES			
FUNDS EMPLOYED AND RESERVES			
Reserves	9	1,731,840	2,454,777
Accumulated Fund	10	(1,797,388)	(7,582,130)
Cess Fund	11	618,594,288	478,478,518
Compensation Fund	12	49,459,089	37,642,655
NON CURRENT LIABILITIES			
Lease Creditor	13	4,566,913	2,315,011
Grant - Capital Expenditure from Cess Fund	14	18,269,284	12,796,042
Retirement Benefit Obligation	15	5,161,801	3,970,048
CURRENT LIABILITIES			
Creditors & Accruals	16	2,621,281	4,630,812
Life Insurance Payable	7	5,636,627	-
Receipts in Advance		409,729	295,240
Current Portion of Lease Creditor	13	2,362,553	2,427,495
TOTAL FUNDS AND LIABILITIES		707,016,017	537,428,468

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.

The Members of the Securities & Exchange Commission of Sri Lanka are responsible for the preparation and presentation of these Financial Statements.

for and on behalf of THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA

Channa De Silva
DIRECTOR GENERAL

Gamini Wickramasinghe
CHAIRMAN

Colombo.
27th March 2006



INCOME AND EXPENDITURE STATEMENT

For the year ended 31st December		2005	2004
	Notes	Rs	Rs
INCOME			
Broker License Fees		431,898	361,829
Unit Trust License Fees		230,000	115,000
Administration Levy		336,290	–
Sale of Publications		33,750	22,500
Management Fee		1,496,375	–
Sundry Income		42,581	34,402
Profit on Disposal of Property, Plant & Equipment		562,992	575,274
Recognition of Grants	14	7,532,812	5,957,003
		10,666,698	7,066,008
Less:			
EXPENDITURE			
Personnel Costs	17	44,005,659	41,086,857
Administration & Establishment Expenses	18	36,062,302	35,373,589
Capital Market Development Expenses	19	6,588,724	3,258,075
IOSCO Conference 2005	20	1,395,719	4,461,389
Finance Charges	21	148,567	122,933
Infrastructure Development Contribution - Tsunami Fund		10,000,000	–
Total Expenditure		98,200,971	84,302,843
Excess Expenditure over Income		(87,534,273)	(77,236,835)
Transfers from Cess Fund to meet Operational Expenses		92,596,078	73,707,535
Prior Year Adjustments		–	(451,445)
Excess/(Deficit) for the year		5,061,805	(3,980,745)

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.



STATEMENT OF CHANGES IN RESERVES

For the year ended 31st December 2005	RESERVES	ACCUMULATED FUND	TOTAL
	Rs.	Rs.	Rs.
Balance as at 1st January 2004	2,454,777	(3,601,385)	(1,146,608)
Net Surplus/(Deficit) for the period	–	(3,980,745)	(3,980,745)
Balance as at 31st December 2004	<u>2,454,777</u>	<u>(7,582,130)</u>	<u>(5,127,353)</u>
Balance as at 1st January 2005	2,454,777	(7,582,130)	(5,127,353)
Decrease due to disposal of revalued assets	(722,937)	722,937	–
Net Surplus/(Deficit) for the period	–	5,061,805	5,061,805
Balance as at 31st December 2005	<u>1,731,840</u>	<u>(1,797,388)</u>	<u>(65,548)</u>

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.



CASH FLOW STATEMENT

For the year ended 31st December	NOTE	2005 Rs	2004 Rs
Cash Flows from Operating Activities			
Net Increase(Decrease) after transfers from Cess Fund		5,061,805	(3,980,745)
Adjustment for			
Depreciation	1	9,336,509	8,677,779
(Profit)/Loss on Disposal of Property, Plant & Equipment		(562,992)	(575,274)
Recognition of Grant	14	(7,532,812)	(5,957,003)
Provision for Gratuity	15	3,238,573	723,218
Prior Year Adjustments		-	451,445
Net Increase(Decrease) before Working Capital Changes		9,541,083	(660,580)
Change of Working Capital			
(Increase)/Decrease of Stocks		5,534	(28,004)
(Increase)/ Decrease of Receivable		(111,832)	(197,171)
(Increase)/Decrease of Deposits Advances & Prepayments		899,038	(739,760)
Increase/(Decrease) of Receipt in Advance		114,489	(15,652)
Increase/(Decrease) of Creditors & Accruals		(2,009,531)	476,614
		(1,102,302)	(503,973)
Cash generated from Operating Activities		8,438,781	(1,164,553)
Gratuity paid during the year		(2,046,820)	-
Net Cash from Operating Activities		6,391,961	(1,164,553)
Extra Ordinary Items - Life Insurance claim received for an employee		5,636,627	-
		12,028,588	(1,164,553)
Cash Flows into Investing Activities			
Purchase of Property Plant and Equipment		(18,306,054)	(7,535,763)
Proceeds from sale of Property Plant & Equipment		3,662,812	702,209
Net Cash from Investing Activities		(14,643,242)	(6,833,554)
Cash Flows from Financing Activities			
Capital Transfer from Cess Fund		13,006,054	6,135,763
Increase (Decrease) in Finance Lease		2,186,960	(569,201)
Net Cash from Financing Activities		15,193,014	5,566,562
Net increase/ (decrease) in Cash and Cash Equivalents		12,578,360	(2,431,545)
Cash and Cash Equivalents at beginning of period (Note a)		101,233	2,532,778
Cash and Cash Equivalents at end of period (Note b)		12,679,593	101,233
Note (a)			
Cash and Cash Equivalents at beginning of period			
Cash at Bank		81,233	2,522,778
Cash in Hand		20,000	10,000
		101,233	2,532,778
Note (b)			
Cash and Cash Equivalents at End of period			
Cash at Bank		7,022,966	81,233
Cash in Hand		20,000	20,000
REPO Investments		5,636,627	-
		12,679,593	101,233

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.



CESS FUND - CASH FLOW STATEMENT

For the year ended 31st December	2005 Rs	2004 Rs
Cash Flows from Operating Activities		
Net Increase of Cess Fund	140,115,770	59,168,962
Net Increase before working capital changes	140,115,770	59,168,962
Change of Working Capital		
(Increase)/Decrease of Staff Loans	646,519	114,660
(Increase)/Decrease of Receivables	123,608	(15,279)
(Increase)/Decrease of Withholding Tax Receivable	-	19,936
(Increase)/Decrease of Interest Receivable on Treasury Bills	(25,584,936)	8,780,932
Increase/(Decrease) of Other Payables	(66,099)	66,099
(Increase)/Decrease of Rent Deposit	(45,890)	2,563,298
	<u>(24,926,798)</u>	<u>11,529,646</u>
Net Cash from Operating Activities	<u>115,188,972</u>	<u>70,698,608</u>
Cash Flows into Investing Activities		
Investment of Treasury Bills	(119,114,161)	(66,722,036)
Net Cash from Investing Activities	<u>(119,114,161)</u>	<u>(66,722,036)</u>
Net Increase/(Decrease) in Cash and Cash Equivalents	(3,925,189)	3,976,572
Cash and Cash Equivalents at beginning of period (Note c)	4,177,612	201,040
Cash and Cash Equivalents at end of period (Note d)	<u>252,423</u>	<u>4,177,612</u>
Note (c)		
Cash and Cash Equivalents at beginning of period		
Cash at Bank	177,612	(4,598,960)
REPO Investments	4,000,000	4,800,000
	<u>4,177,612</u>	<u>201,040</u>
Note (d)		
Cash and Cash Equivalents at end of period		
Cash at Bank	252,423	177,612
REPO Investments	-	4,000,000
	<u>252,423</u>	<u>4,177,612</u>

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.



COMPENSATION FUND - CASH FLOW STATEMENT

For the year ended 31st December	2005	2004
	Rs	Rs
Cash Flows from Operating Activities		
Net Increase of Compensation Fund	11,816,434	8,190,558
Net Increase before Working Capital Changes	11,816,434	8,190,558
Change of Working Capital		
(Increase)/Decrease of Interest Receivable on Treasury Bills	(1,709,127)	385,219
Increase/(Decrease) of Other Payables	(10,256)	10,256
	(1,719,383)	395,475
Net Cash from Operating Activities	10,097,051	8,586,033
Cash Flows into Investing Activities		
Investment in Treasury Bills	(10,158,789)	(8,500,693)
Net cash from investing activities	(10,158,789)	(8,500,693)
Cash Flows from Financing Activities		
Net Increase/(Decrease) in Cash and Cash Equivalents	(61,738)	85,340
Cash and Cash Equivalents at beginning of period (Note e)	127,327	41,987
Cash and Cash Equivalents at end of period (Note f)	65,589	127,327
Note (e)		
Cash and Cash Equivalents at beginning of period		
Cash at Bank	109,968	(15,167)
Call Deposits	17,359	57,154
	127,327	41,987
Note (f)		
Cash and Cash Equivalents at end of period		
Cash at Bank	48,229	109,968
Call Deposits	17,360	17,359
	65,589	127,327

The Accounting Policies and Notes appearing on pages 8 to 21 form an integral part of the Financial Statements.



SIGNIFICANT ACCOUNTING POLICIES

1. SIGNIFICANT ACCOUNTING POLICIES

1.1 BASIS OF PREPARATION

The Financial Statements of the Commission are presented in Sri Lankan Rupees rounded to the nearest Rupee.

The Financial Statements of the Commission are prepared under the historical cost convention in accordance with the Sri Lanka Accounting Standards adopted by the Institute of Chartered Accountants of Sri Lanka. Where appropriate accounting policies are disclosed in succeeding notes.

1.2 CONVERSION OF FOREIGN CURRENCY

All foreign exchange transactions are converted to Sri Lanka Rupees, which is the reporting currency, at the rates of exchange prevailing at the time of the transaction except the foreign currency accounts pertaining to International Organization of Securities Commissions (IOSCO) Conference that were converted at average rate.

1.3 EVENTS AFTER THE BALANCE SHEET DATE

All material events after the Balance Sheet Date are considered and appropriate adjustments or disclosures are made in the Financial Statements, where necessary.

1.4 COMPARATIVE FIGURES

Comparative figures have been adjusted to conform to the changes in presentation in the current financial year.

2. ASSETS & BASES OF VALUATION

2.1 PROPERTY, PLANT AND EQUIPMENT

OWNED PROPERTY PLANT AND EQUIPMENT

Property, Plant & Equipment together with any incidental expenses thereon are stated at cost or as per the revaluation and depreciated at their respective useful lives. Fixed assets received as grants, were accounted at their fair value and depreciation thereof is charged against the respective reserve account. In respect of disposal of revalued assets the balance remaining in the revaluation reserve is charged to the Accumulated Fund. The depreciation is provided on the straight-line basis applying following rates:

Motor Vehicles	25.00%
Furniture, Fixtures and Fittings	12.50%
Office Equipment & EDP Equipment	25.00%
Training Equipment	25.00%

Full year depreciation is provided for all assets purchased during the first half of the financial year and no depreciation is provided for assets purchased during the second half of the year.

2.2 LEASED MOTOR VEHICLES

The assets on finance lease which effectively transfer to the Commission substantially all of the risk and benefits incidental to ownership of the leased item is capitalized at cash cost. Depreciation and finance charges arising out of such leasehold assets are charged to the Income & Expenditure account whilst the payments of lease rental are recognized to reduce the lease liability.

2.3 INVESTMENTS

Government Treasury bills are stated at cost or market value whichever is lower.

2.4 INVENTORIES

Inventories are valued at lower of cost and net realizable value. The cost of inventories is valued on first-in, first-out (FIFO) basis.

2.5 RECEIVABLES

Receivables are stated at the estimated realizable value.

2.6 CASH AND CASH EQUIVALENTS

For the purpose of the Cash Flow Statement, Cash and Cash Equivalents consist of cash and deposits held on call with banks.

3. LIABILITIES & PROVISIONS

3.1 RETIREMENT BENEFITS

In terms of Gratuity Act No. 12 of 1983 the liability to an employee arises only upon completion of 5 years of continued service. To meet the liability a provision is made, equivalent to half month's salary based on the last month of the financial year for all employees who have completed one year of service.

3.1.2 DEFINED CONTRIBUTION PLANS

All permanent employees' are eligible for Employees' Provident Fund Contributions and Employees' Trust Fund Contributions in line with the respective statutes and regulations. The Commission contributes 12% and 3% of gross emoluments of employees to Employees' Provident Fund and Employees' Trust Fund respectively.

3.2 ACCOUNTS PAYABLE

Payables are stated at cost.

3.3 GRANT

Capital Expenditure transferred from the Cess Fund is treated as a grant and recognized on the estimated useful life of the asset.

4. INCOME & EXPENDITURE

4.1 REVENUE RECOGNITION

Revenue is recognized on accrual basis.

4.2 EXPENDITURE RECOGNITION

All expenditure incurred in maintaining the Commission has been charged to revenue in ascertaining the income over expenditure.

4.3 CASH FLOW STATEMENT

The Cash Flow Statement has been prepared using the indirect method.



NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December 2005

1. Property, Plant & Equipment

	Motor Vehicles	Furniture, Fixtures & Fittings	Office Equipment (EDP & Others)	Training Equipment	Assets on Finance Lease Motor Vehicles	Total
COST						
Balance as at 1st January 2005	8,425,000	4,284,118	15,874,055	1,836,400	8,400,000	38,819,573
Additions during the Year	11,505,900	62,373	1,437,781	–	5,300,000	18,306,054
Disposals during the year	(2,675,000)	(18,359)	(372,730)	–	(2,800,000)	(5,866,089)
Balance as at 31st December 2005	17,255,900	4,328,132	16,939,106	1,836,400	10,900,000	51,259,538
ACCUMULATED DEPRECIATION						
Balance as at 1st January 2005	4,568,750	1,691,573	9,503,461	1,331,775	3,500,000	20,595,559
Depreciation Charge for the Year	3,801,475	535,515	2,434,810	218,875	2,345,834	9,336,509
Accumulated Depreciation On Disposal of Assets	(668,750)	(12,239)	(364,446)	–	(1,720,834)	(2,766,269)
Balance as at 31st December 2005	7,701,475	2,214,849	11,573,825	1,550,650	4,125,000	27,165,799
Written Down Value As At 31st December 2005	9,554,425	2,113,283	5,365,281	285,750	6,775,000	24,093,739
Written Down Value As At 31st December 2004	3,856,250	2,592,545	6,370,594	504,625	4,900,000	18,224,014

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
2. CESS INVESTMENT AND OTHERS		
ASSETS		
Staff Loans	4,643,965	5,290,484
Rent Deposits	4,825,032	4,779,142
Withholding Tax Receivables	400,341	400,341
Investment in Treasury Bills	575,017,276	455,903,115
Investment in Call Deposits	–	4,000,000
Interest Receivable on Treasury Bills	31,675,770	6,090,834
Cess Receivables	1,779,481	1,903,089
Balance at Bank	252,423	177,612
	618,594,288	478,544,617
LIABILITIES		
Other Payables	–	66,099
	618,594,288	478,478,518
3. COMPENSATION INVESTMENT AND OTHERS		
ASSETS		
Investment in Treasury Bills	46,564,922	36,406,133
Investment in Call Deposits	17,360	17,359
Withholding Tax Receivable on Call Deposit	72,445	72,445
Interest Receivable on Treasury Bills	2,756,133	1,047,006
Balance at Bank	48,229	109,968
	49,459,089	37,652,911
LIABILITIES		
	–	10,256
	49,459,089	37,642,655
4. INVENTORIES		
Stock of Stationery & EDP Consumables	398,124	253,022
Stock of Publications	1,380	128,431
	399,504	381,453
5. RECEIVABLES		
Sundry Debtors Including Debit Notes	257,035	30,365
With Holding Tax Receivable	5,399	5,399
Staff Recoveries	144,651	253,739
Festival Advances	447,500	453,250
	854,585	742,753

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
6. DEPOSITS, ADVANCES & PRE-PAYMENTS		
Safe Vault Deposit - Bank of Ceylon	20,000	20,000
Deposit for Cellular Phones	40,000	40,000
Fuel Deposit	55,000	55,000
Deposit for Vehicle Maintenance	500	500
Deposits with Telecom Ltd	43,925	43,925
Other Deposits	211,999	234,190
Advances to Suppliers	562,511	1,439,358
	933,935	1,832,973
7. LIFE INSURANCE PAYABLE		
Bank of Ceylon Repo Investment	5,636,627	-
	5,636,627	-
<p>(The life insurance claim received on account of a former employee is invested in a Repo account until the life insurer's testamentary case is over)</p>		
8. CASH		
Cash at Bank	7,022,966	81,233
Cash in Hand	20,000	20,000
	7,042,966	101,233
9. RESERVES		
REVALUATION SURPLUS		
Balance at the beginning of the period	2,454,777	2,861,010
Less: Disposal of Assets	(722,937)	(406,233)
Balance at the end of the period	1,731,840	2,454,777
10. ACCUMULATED FUND		
Balance at the beginning of the period	(7,582,130)	(4,007,618)
Add: Decrease due to the revaluation	722,937	406,233
Net Surplus/(Deficit) for the period	5,061,805	(3,980,745)
Balance at the end of the period	(1,797,388)	(7,582,130)
11. CESS FUND		
Opening Balance	478,478,518	419,309,556
Add: Cess Received during the year	206,276,152	106,351,594
Interest on Investment	39,732,085	32,925,569
	724,486,755	558,586,719
Less: Transfers to Operational & Capital Expenditure	105,602,132	79,843,298
Expenses	22,900	250
Custodian Fees	267,435	264,653
	105,892,467	80,108,201
Closing Balance	618,594,288	478,478,518

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
12. COMPENSATION FUND		
Opening Balance	37,642,655	29,452,097
Compounding fees received during the year	8,650,000	5,800,000
Add : Interest on Investment - Treasury Bills	3,197,798	2,416,647
- Call Deposits	-	6,478
	49,490,453	37,675,222
Less: Custodian Fees	21,904	19,430
Bank Charges	9,460	13,137
	31,364	32,567
Closing Balance	49,459,089	37,642,655
13. LEASE CREDITOR		
Gross Lease Liabilities	8,505,881	5,483,891
Interest in Suspense	(1,576,415)	(741,385)
	6,929,466	4,742,506
Less: Payable within one year	(2,362,553)	(2,427,495)
Payable after one year	4,566,913	2,315,011
14. GRANT - CAPITAL TRANSFERS FROM CESS FUND		
Balance Brought Forward	12,796,042	11,378,532
Transfers During the Year	13,006,054	6,135,763
Less: Transferred to Income for Assets Depreciation	(7,532,812)	(4,718,253)
	18,269,284	12,796,042
RECOGNITION OF GRANT		
Capital Grants - Treasury	-	1,238,750
Capital Transfers from Cess Fund	7,532,812	4,718,253
	7,532,812	5,957,003
Note		
Recognition of Grant		
Capital Transfers from Cess Fund		
Recognition of Grant in accordance with the SLAS 24 at the following rates.		
Motor Vehicles	25.00%	
Office Equipment - Others & EDP	25.00%	
Training Equipment	25.00%	
Furniture, Fixtures & Fittings	12.50%	
15. RETIREMENT BENEFIT OBLIGATION		
Balance Brought Forward	3,970,048	3,246,830
Charge for the Year	3,238,573	723,218
Gratuity Paid During the Year	(2,046,820)	-
	5,161,801	3,970,048

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
16. CREDITORS AND ACCRUALS		
Telephone Expenses	198,854	251,620
Electricity	49,075	80,000
Fuel Expenses	43,568	60,000
IOSCO Payable	123,473	194,710
Staff Medical Reimbursements	144,627	146,440
Leave Encashment	207,165	152,904
External Audit Fees	150,000	217,123
Annual Report Printing	1,500,000	1,150,000
Newspapers & Periodicals	4,755	4,111
VAT Payable	106,743	85,946
Other Payables	67,256	331,981
Staff Welfare	25,765	-
PAYE Tax	-	168,265
E.P.F. Payable	-	303,683
E.T.F. Payable	-	46,864
Members Fees	-	27,656
Foreign Travel	-	706,289
Interest Subsidy	-	4,424
Compensation	-	441,840
Security Charges	-	21,160
Office Upkeep	-	11,141
Internal Audit Fees	-	224,656
	2,621,281	4,630,812
17. PERSONNEL COSTS		
Staff Salaries	20,767,373	19,915,013
Chairman's Allowance	337,956	255,573
Overtime	573,134	401,382
Interns Allowance	64,326	-
E P F & E T F	3,107,671	2,873,851
Staff Medical Expenses & Insurance	1,777,035	1,213,689
Ex-Gratia payment	412,873	480,038
Staff Gratuity	3,238,573	723,218
Leave Encashment	526,382	188,798
Compensation A/c	119,962	441,840
Staff Housing Loan Interest Subsidy	419,577	396,212
Staff Welfare	744,313	623,490
Staff Travelling Allowance	73,800	677,826
Reimbursement of Fuel - Directors	672,610	649,585
Foreign Travel & Training - Staff	4,631,265	8,303,221
Foreign Travel - Commission Members	4,243,416	3,045,591
Staff Training - Local	911,239	897,530
Temporary Allowance paid for IBSL work	1,384,154	-
	44,005,659	41,086,857

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
18. ADMINISTRATION & ESTABLISHMENT EXPENSES		
Member Meeting Expenses	231,154	282,814
Entertainment	221,281	146,849
Rent & Car Park Rental	10,986,373	10,939,123
Electricity Charges	1,308,145	1,193,522
Telephone, Internet, E- mail & Web	2,736,203	1,923,584
Motor Vehicle Maintenance & Insurance	873,895	796,986
Legal Expenses	371,375	1,224,628
Donation A/c	-	788
Professional Fees	2,185,498	2,519,626
International Membership Fees	1,083,938	1,033,675
Depreciation	9,336,509	8,677,779
Cost of Publication	16,450	14,077
Obsolete stocks	125,668	37,300
Advertising	256,300	377,340
Market Surveillance Cost	1,144,841	1,073,751
Security Charges	257,370	228,737
Library Books	88,906	31,120
Printing & Stationery	2,304,678	2,260,954
Travelling Local	88,477	125,953
Office Equipment Maintenance & Insurance	534,310	426,883
Insurance Fire & Personal Accident	272,598	291,524
News Papers & Periodicals	64,374	75,455
Office Upkeep	156,178	236,623
Investigation Expenses	-	196,355
Postage	46,145	121,782
Courier Charges	167,182	148,746
Audit Fees -Internal	96,060	349,312
Audit Fees -External	150,000	119,248
General Expenses	37,426	3,986
Trade Tax	5,000	5,000
Vat Expenses	374,970	-
Lease Finance Charges	540,998	510,069
	36,062,302	35,373,589
19. CAPITAL MARKET DEVELOPMENT		
Capital Market Development - contribution to CSE Kandy branch	1,000,000	-
Public Awareness Program	5,588,724	3,258,075
	6,588,724	3,258,075

NOTES TO THE FINANCIAL STATEMENTS *Contd*

For the year ended 31st December	2005 Rs.	2004 Rs.
20. IOSCO CONFERENCE 2005		
Income		
Registration Fee	23,482,648	-
Accommodation Fee	19,111,665	-
Accompanies Persons Fee	2,125,717	-
Tours	932,183	-
Exhibition Booths	1,308,942	-
Interest earned	127,112	-
Total Income	47,088,267	-
Less		
Expenditure		
Iosco Hosting Fee	15,567,952	-
Hotel Accommodation	10,824,658	100,000
BMICH	4,193,694	200,000
Conference Planning, Admn. & Organising Fee	3,252,230	147,930
Transport	352,461	-
Interpreters, Translators, & Panelist	2,662,385	-
Information Technology & Telecommunication	1,022,999	28,750
Stationery	1,806,454	1,988
Interior Decorations	142,100	-
Complimentary Items	716,755	-
Entertainment	3,600,646	-
Welfare	949,349	-
Advertising	746,568	-
Miscellaneous	260,820	20,732
Human Resources	1,382,340	427,996
IOSCO Foreign Travel	287,591	-
Bank Charges	660,546	-
IOSCO Promotional Expenses	-	3,533,993
Exchange Loss	54,438	-
Total Expenditure	48,483,986	4,461,389
Expenditure Over Income	1,395,719	4,461,389
<p>The following organisations sponsored lunches/dinners for the participants of IOSCO Conference 2005 amounting to Rs. 10 Million. The respective organisations settled the hotel bills directly.</p>		
Colombo Stock Exchange		3 Million
Millenium IT		3 Million
Stock Brokers Association of Sri Lanka		1.3 Million
Insurance Association of Sri Lanka		2.7 Million
21. FINANCE CHARGES		
Bank Charges	56,800	70,250
Debit Tax	91,767	52,683
	148,567	122,933



NOTES TO THE FINANCIAL STATEMENTS *Contd*

22. TAXATION

The Commission is not liable for income tax in terms of the Inland Revenue Act No. 28 of 1979 as amended by Act No. 38 of 2000.

23. CAPITAL COMMITMENTS

There were no capital commitments as at 31st December 2005

24. CONTINGENT LIABILITIES

There were no contingent liabilities as at 31st December 2005

25. EVENTS AFTER THE BALANCE SHEET DATE

No material events have occurred after the Balance Sheet date necessitating any adjustments or disclosure in the Financial Statements.

26. RELATED PARTY DISCLOSURES

Dr Dayanath C Jayasuriya resigned from the post of Chairman along with the following Members of the Commission Mrs Dayani De Silva, Mr N Hatch P.C., Dr (Mrs) Raneer Jayamaha, Mr Udayasri Kariyawasam, Prof. (Mrs) Savitri Goonesekere and Mr O M Weerasooriya with effect from 6.12.05, 8.12.05, 6.12.05, 7.12.05, 6.12.05, 16.12.05 and 6.12.05 respectively.

Mr A I Fernando's term as an Ex-officio Member of the Commission expired on 19.12.05 after completing his term of office as President, Institute of Chartered Accountants of Sri Lanka.

Mr Yohan Perera was appointed to the Commission as Ex-Officio Member for a period of two years commencing 20.12.05 by virtue of him holding office of President, Institute of Chartered Accountants of Sri Lanka established by the Chartered Accountants Act. No 23 of 1959.

Mr D K Hettiarachchi and Mr Sumith Abeysinghe were the only two Members that held office during the entire financial year.

The following Members of the SEC were also Members of the Insurance Board of Sri Lanka (IBSL) except Mr Channa de Silva who was the Director General of the SEC. Their dates of appointments and resignations to/from the IBSL are given below.

Dr Dayanath C. Jayasuriya	Member/Chairman resigned w.e.f. 06.12.05
Mrs Dayani De Silva	Member resigned w.e.f. 08.12.05
Dr (Mrs) Raneer Jayamaha	Member resigned w.e.f. 7.12.05
Mr Udayasri Kariyawasam	Member resigned w.e.f. 06.12.05
Mr O M Weerasooriya	Member resigned w.e.f. 06.12.05
Mr Channa de Silva	Member appointed w.e.f. 30.3.05

Mr Sumith Abeysinghe Member of the Commission also held office as Member of the IBSL during the whole financial year.



NOTES TO THE FINANCIAL STATEMENTS *Contd*

Name	Name of Institution	Position
Mr D K Hettiarachchi	<ul style="list-style-type: none"> Sri Lanka Accounting Standards and Monitoring Board 	Member
Mr Sumith Abeysinghe	<ul style="list-style-type: none"> Securities and Exchange Commission of Sri Lanka Bank of Ceylon University Grants Commission Southern Development Authority De-La Rue Lanka Settlement Guarantee Fund 	Member (Treasury Nominee) Director (Treasury Nominee) Director (Treasury Nominee) Director (Treasury Nominee) Director (Treasury Nominee) Trustee
Mr Yohan Perera	<ul style="list-style-type: none"> Institute of Chartered Accountants of Sri Lanka KPMG Ford, Rhodes, Thornton & Co Industrial and Commercial Consultants Ltd FRT Holdings (Pvt) Ltd 	President President Director Director

The following table depicts the Directorships held by the Members of the Commission at the end of the financial year.

Name	Name of Institution	Position
Dr Dayanath C Jayasuriya	<ul style="list-style-type: none"> Insurance Board of Sri Lanka Settlement Guarantee Fund Public Utilities Commission National Procurement Agency 	Chairman (resigned w.e.f. 6.12.05) Trustee (resigned w.e.f. 6.12.05) Director(resigned w.e.f. 6.12.05) Director (resigned w.e.f. 6.12.05)
Mr A I Fernando	<ul style="list-style-type: none"> Institute of Chartered Accountants of Sri Lanka Bartleet TransCapital (Pvt) Ltd Sungold Confectioneries (Pvt) Ltd National Institute of Management Post Graduate Institute of Management Sri Jayawardenapura 	President (term expired on 19.12.05) Director/CEO Do Do Member of the Board of Management
Mrs Dayani De Silva	<ul style="list-style-type: none"> Insurance Board of Sri Lanka National Procurement Agency 	Member (resigned w.e.f. 8.12.05) Member of the Board of Management
Mr N Hatch P C	<ul style="list-style-type: none"> Sri Lanka Telecom Ltd Mobitel (Pvt) Ltd 	Director Director
Dr (Mrs) Ranees Jayamaha	<ul style="list-style-type: none"> Insurance Board of Sri Lanka Credit Information Bureau National Council for Economic Development – Financial Sector Cluster 	Member (resigned w.e.f. 7.12.05) Chairman Co-Chairperson
Mr Udayasri Kariyawasam	<ul style="list-style-type: none"> Insurance Board of Sri Lanka 	Member (resigned w.e.f. 6.12.05)
Prof. (Mrs) Savitri Goonesekere	-	-
Mr O M Weerasooriya	<ul style="list-style-type: none"> Insurance Board of Sri Lanka 	Member (resigned w.e.f. 6.12.05)



NOTES TO THE FINANCIAL STATEMENTS *Contd*

The following table depicts the Directorships held by the Members of the Commission during the period in which they held office in the financial year.

The following amounts were received in respect of goods & services rendered to the IBSL.

	Rs.
Temporary allowance received by the staff of the SEC for discharging the mandate of the Board from January 2005 to April 2005	1,544,814
Seconded Staff Salaries & other benefits from May 05 to December 05	2,065,176
Management Fee from May 2005 to December 2005	1,496,375
Vehicle Hire	68,040
Printing & Stationery	267,761
Courier Charges	1,412
Total	<u>5,443,578</u>

Rent and other related expenditure were not levied to the IBSL which was housed at SEC premises during the period January 2005 to April 2005. The IBSL utilized the fixed assets of the SEC free of charge during the first four months of the financial year.

Other than the normal business transactions and the above mentioned transactions recorded there were no related party transactions.



REPORT OF THE AUDITOR GENERAL

The Chairman
Securities and Exchange Commission of Sri Lanka.

Report of the Auditor General on the accounts of the Securities and Exchange Commission of Sri Lanka for the year ended 31 December 2005 in terms of Section 14 (2) (c) of the Finance Act No. 38 of 1971.

The audit of accounts of the Securities and Exchange Commission of Sri Lanka (SEC) for the year ended 31 December 2005 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 Act No. 36 of 1987. My 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 will be furnished to the Chairman of the Commission in due course.

1:2. Scope of Audit

Audit opinion, comments and findings in this report are based on a review of the financial statements presented to audit and substantive test of samples of transactions. The scope and the extent of such review and tests were such as to enable as wide an audit coverage as possible within the limitation of staff, other resources and time available to me. The audit was carried out in accordance with Sri Lanka Auditing Standards, methods and practices to obtain reasonable assurance as to whether the financial statements are free of material misstatements. The audit included examination of evidence supporting the amounts and disclosures in financial statements and assessment of accounting principles and significant estimates and judgements made in the preparation of financial statements, evaluation of their overall presentation and determining whether accounting policies adopted were appropriate, consistently applied and adequately disclosed. 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.

2. Accounts

2:1 Audit opinion

I am of opinion so far as appears from my examination and to the best of my information and according to the explanations given to me, the financial statements have been prepared and presented in accordance with Sri Lanka Accounting Standards and the stated accounting policies

as set out in notes (Nos. 01 to 4.3) to the financial statements and give a true and fair view of the financial position of the Commission as at 31 December 2005, and the financial result and cash flow for the year then ended.

2:2 Comments on Accounts

2:2:1 Non compliance with Laws, Rules, Regulations and Management decisions

Following instances of non-compliance were observed in audit.

Reference to Laws, Rules, Regulations and Management decisions	Particulars
(a) Decision of the Commission at 185th meeting held on 22 September 2003	Arrangement had been made to pay Rs. 1000 each per day for all participants of the workshops conducted for the academics of all Universities in Sri Lanka contrary to Commission decision.
(b) Section 11 - 1 of Chapter XV of the Establishments Code	The Business class of the air travel had been used for the top level officers of the Commission without obtaining the requisite Approval from the authorities. A sum of Rs. 2,491,019 had been spent in this connection from January to December 2005.

3. Financial and Operating Review

3:1 Financial Results

According to the accounts presented, the operation of the Commission for the year ended 31 December 2005 had resulted in a net deficit of Rs. 87,534,273 before taking into account the transfers from Cess Fund for operational expenses as compared with the corresponding net deficit of Rs. 77,236,835 before taking into account the transfers from Cess Fund for the preceding year. The operating surplus for the year under review after taking into accounts the transfers from the Cess Fund for operational expenses for the year amounted to Rs. 5,061,805 as against the net deficit of Rs. 3,980,745 in the preceding year after taking into accounts the transfers from the Cess Fund for the year.

3.2. Uneconomic Transaction

Following observations are made.

a) A sum of Rs. 600,000 had been paid to a consultant for



REPORT OF THE AUDITOR GENERAL *Contd*

carrying out a study to formulate an action plan to set up a Capital Market Training Institute and to design a course structure for the prospective participants who were to be trained in such institute. Although the consultant had finalized the assignment and forwarded the report to the Commission, no action had been taken to establish such training institute up to end of the year under review.

b) A sum of Rs. 259,500 had been incurred for the conducting a staff residential training programme for employees to develop their leadership skills and teamwork, build confidence and have their positive outlook. It was not possible to be satisfied in audit the effectiveness of the above programme due to following reasons.

- (i) Out of 35 of the staff, only 25 employees had participated in this programme and average expenditure for one participant was Rs. 10,380.
- (ii) Enough local and foreign training opportunities had been given for every employees to develop their skills.
- (iii) Above training programme had been conducted for last six years and hence expected skills of the employees already would have been improved.

c) A sum of Rs. 99,200 had been paid for the participants of the number of awareness programme on share market conducted in the National Institute of Education. It was not possible to be satisfied in audit the necessity of conducting the awareness programmes by providing money only without having evaluation of the above programme.

d) Following were observed in respect of the expenses incurred on International Organization of Securities Commission Conference (IOSCO) held in Sri Lanka in April 2005.

- (i) A sum of Rs. 315,000 had been incurred as a compensation due to cancellation the allocated exhibition stalls required for the IOSCO conference. The Commission had to bear this loss due to handling the allocation of exhibition stalls by an officer recruited on temporary basis although the Institution had enough staff.
- (ii) Service of 6 officers had been obtained on temporary basis stating that the Commission has no adequate professional staff to conducting the IOSCO conference. However, out of them, service of 4 officers assigned to the duties which are not required for the professional qualification could have been obtained from the permanent staff of the Commission who were trained in local and foreign training. A sum of Rs. 1,800,198 had been spent

by the Commission as professional charges on this from October 2004 to May 2005.

- (iii) A sum of Rs. 413,074 had been paid for hiring vehicles to transport the delegates participated for the IOSCO conference. Responsibility for the handling the transport arrangement assigned to the officers recruited on temporary basis and an additional transport charges of Rs. 68,900 had been paid for an organization due to non furnishing the time of correct arrival of the flight details of the delegations.
- (iv) A sum of Rs. 72,000 had been spent for the temporary Health Centre established for the IOSCO. It is not clear in audit the necessity of a such centre due to following reasons.

There are reputed private and Government hospitals in close proximity of the conference held. Enough vehicles had been hired for their transportation.
- (v) When obtaining the service for printing the Greeting cards for the IOSCO conference it had been accepted the highest quotation of Rs. 34,730 rejecting lowest price of Rs. 18,700. The required standard was the reasons for the above decision which were not considered when calling for quotations. Therefore, an additional cost of Rs. 16,030 had been incurred by the Commission due to above transaction.

3:3 Idle and Under - utilized Assets

The Access Control System installed in the office premises of the Commission spending a sum of Rs. 690,862 had been abundant at the end of the previous year as the Commission had an opinion that it did not serve any useful purpose.

3:4 Transaction of a Contentious Nature

All the expenses including the economic class of air fair for the participation of one of the Commission members for the programme held in Dhaka in Bangladesh had been reimbursed by the International Financial Corporation (IFC). However, this Commission member had travelled on business class and the additional cost of the air ticket of Rs. 40,899 had been borne by the SEC.

3:5 Corporate Plan

The Commission had not prepared a Corporate plan for the year 2005 and onwards in terms of Section 5:1:3 of chapter 5 of the Public Enterprises Circular No. PED/12, to incorporate strategies regarding the future direction of the Commission.



REPORT OF THE AUDITOR GENERAL *Contd*

3:6 Activities of the Commission

- a) Publication of the fourth edition of the Booklet on the Securities Market in Sri Lanka authored by a leading professional which was identified as a core function of the Commission was only an updated publication of the third edition of the same booklet. However, this also had not been completed even after end of the year under review.
- b) There were some instances of acquiring substantial interest in share ownership of certain Commercial Banks by some share holders through the subsidiaries and associated companies under their conglomeration. It was observed in audit that by this trend it was not much benefited to the economy of the country as well as to the position of the SEC as it is the regulatory body in the share market.

4. Systems and Controls

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

- a) Usage of telephone
- b) Nomination for foreign training

S. C. MAYADUNNE
AUDITOR GENERAL



Responses of the Commission to the matters raised by the Auditor General in his report issued in terms of Section 14(2)(c) of the Finance Act No. 38 of 1971 on the Accounts of the Securities and Exchange Commission of Sri Lanka for the year 2005

Auditor General's Observations	SEC Responses
<p>2.2 Comments on Accounts</p> <p>2.2.1 Non-compliance with Laws, Rules, Regulations and Management decisions</p> <p>Following instances of non-compliance were observed in audit.</p> <p>Reference to Laws, Rules, Regulations and Management decisions</p> <p>(a) Decision of the Commission at 185th meeting held on 22nd September 2003.</p> <p>Arrangement had been made to pay Rs.1,000/- each per day for all participants of the workshops conducted for the academics of all Universities in Sri Lanka contrary to Commission decision.</p> <p>(b) Section 11-1 of Chapter XV of the Establishments Code.</p> <p>The Business class of the air travel had been used for the top-level officers of the Commission without obtaining the requisite approval from the authorities. A sum of Rs 2,491,019/- had been spent in this connection from January to December 2005.</p>	<p>The SEC invited academics from all universities in Sri Lanka to attend the programme conducted on Capital Markets. Officials representing Government Universities as far as from Jaffna, Batticaloa attended this programme. A sum of Rs 1000/- each was paid to compensate the academics towards expenditure connected with traveling and subsistence.</p> <p>From the inception the Chairman, Members of the Commission and the Director General had been traveling business class for official purposes. The SEC as the regulatory body for the capital market which includes listed companies needs to maintain at least the same standard as a Chairman or a Managing Director of a leading listed company. The senior officials of most Securities and Exchange Commission in other jurisdictions too travel on business class. This is not a luxury but a necessity to maintain the image of the SEC.</p>
<p>3.2 Uneconomic Transaction</p> <p>Following observations are made.</p> <p>a) A sum of Rs 600,000/- had been paid to a consultant for carrying out a study to formulate an action plan to set up a Capital Market Training Institute and to design a course structure for the prospective participants who were to be trained in such institute. Although the consultant had finalized the assignment and forwarded the report to the Commission, no action had been taken to establish such training institute up to end of the year under review.</p>	<p>To set up a Capital Market Training Institute is included in the Corporate Plan of the SEC 2006 and will initiate implementation from first quarter 2006.</p>
<p>(b) A sum of Rs 259,500/- had been incurred for the conducting a staff residential training programme for employees to develop their leadership skills and teamwork, build confidence and have their positive outlook. It was not possible to be satisfied in audit the effectiveness of the above programme due to the following reasons.</p>	

**Responses of the Commission ... Contd**

Auditor General's Observations	SEC Responses
<p>(i) Out of 35 of the staff, only 25 employees had participated in this programme and average expenditure for one participants was Rs 10,380/-</p> <p>(ii) Enough local and foreign training opportunities had been given for every employees to develop their skills.</p> <p>(iii) Above training programme had been conducted for last six years and hence expected skills of the employees already would have been improved.</p>	<p>Training is an ongoing process and not a one off event. Training is provided to the staff of the Secretariat to keep them abreast of technical developments in the capital markets, leadership skills, teamwork, build confidence and to motivate them.</p> <p>A specialist trainer was selected during the year under review to focus on developing leadership skills, teamwork, build confidence, to motivate the staff and enhance understanding and outlook.</p> <p>This year's programme was attended by 25 employees, whilst the rest had valid reasons for not attending same.</p>
<p>(c) A sum of Rs 99,200/- had been paid for the participants of the number of awareness programme on share market conducted in the National Institute of Education. It was not possible to be satisfied in audit the necessity of conducting the awareness programmes by providing money only without having evaluation of the above programme.</p>	<p>Training at the Institute of National Education at Maharagama is an ongoing process undertaken by the Secretariat with the intension of educating the younger generations on Capital Markets.</p> <p>It must be noted that the SEC initiated Capital Market as part of a subject in the GCE Ordinary Level and GCE Advanced Level curriculums in Sri Lanka. Having embarked on the said initiative it is the responsibility of the SEC to educate the teachers on development of Capital Markets and its latest trends. The final aim of the SEC is to ensure a literate society on Capital Markets.</p> <p>SEC has continuously upgraded the training programme through on-going dialogs with participants.</p>
<p>(d) Following were observed in respect of the expenses incurred on International Organization of Securities Commission Conference (IOSCO) held in Sri Lanka in April 2005.</p> <p>(i) A sum of Rs. 315,000/- had been incurred as a compensation due to cancellation the allocated exhibition stalls required for the IOSCO conference. The Commission had to bear this loss due to handling the allocation of exhibition stalls by an officer recruited on temporary basis although the Institution had enough staff.</p> <p>(ii) Service of 6 officers had been obtained on temporary basis stating that the Commission has no adequate professional staff to conducting the IOSCO conference. However, out of them, service of 4 officers assigned to the duties which are not required for the professional qualification could have been obtained from the permanent staff of the Commission who were trained in local and foreign training. A sum of Rs 1,800,198/- had been spent by the Commission as professional charges on this from October 2004 to May 2005.</p>	<p>The Secretariat received sponsorships to the tune of Rs 10 mn for the IOSCO Conference from the following organizations where the SEC in return provided exhibition stalls at the Conference venue. This action in fact ended up in a gain of Rs 10 mn against a cost of Rs 315,000/- as a result of taking back 7 stalls from an Organization.</p> <p>Colombo Stock Exchange sponsored the 3rd night dinner – costing approximately 3 mn - 2 stalls Millenium IT – sponsored 4 lunches during the Conference costing approximately 3 mn – 3 stalls Insurance Association and Stock Brokers Association sponsored the 1st night dinner costing 4 mn - 2 stalls</p> <p>Representing the IOSCO Conference hosting almost 375 foreign participants from over 80 countries the Securities Commissions around the globe certainly need professional expertise to arrange same. The staff of the SEC is not trained to organize a Conference of this magnitude. They are trained in regulatory aspects of Capital Markets. The SEC staff could not be released for Conference duties as they were entrusted with routine duties.</p> <p>The conference of this magnitude required specialized, dedicated staff. The service profiles of 6 officers recruited on contract basis are as follows.</p>

**Responses of the Commission ... Contd**

Auditor General's Observations	SEC Responses
<p>(iii) A sum of Rs 413,074/- had been paid for hiring vehicles to transport the delegates participated for the IOSCO conference. Responsibility for the handling the transport arrangement assigned to the officers recruited on temporary basis and an additional transport charges of Rs 68,900/- had been paid for an organization due to non furnishing the time of correct arrival of the flight details of the delegations.</p> <p>(iv) A sum of Rs 72,000/- had been spent for the temporary Health Center established for the IOSCO. It is not clear in audit the necessity of a such center due to following reasons,</p> <p>There are reputed private and Government hospital in close proximity of the conference held.</p> <p>Enough vehicles had been hired for their transportation.</p> <p>(v) When obtaining the service for printing the Greeting cards for the IOSCO Conference it had been accepted the highest quotation of Rs 34,730/- rejecting lowest price of Rs 18,700/-. The required standard was the reasons for the above decision which were not considered when calling for quotations. Therefore, an additional cost of Rs 16,030/- had been incurred by the Commission due to above transaction.</p>	<p>Professional Conference Organizer AIAPCO trained Security Consultant – Retired DIG IT Specialist Degree holder to handle – Registrations, reservations etc. 2 Executive Secretaries attending to the secretarial work Secretarial work required for a Conference of this magnitude is vast and varied. On an average 50-100 emails, telephone conversations, letters were handled per day.</p> <p>Some of the delegates who attended the Conference had not given accurate arrival details and/or informed changes made to their itinerary. Having charged US\$ 700 to US\$ 1200 per participant, the SEC was obliged to provide transport to the delegates. It would have been unethical as an organizer and a country with a good reputation for hospitality to refuse delegates transportation on their arrival at the Airport.</p> <p>A fleet of vehicles were necessary as SEC the Conference Organizer, had included provision of transport as part of the package. Transport was provided to the VIPs, Officials and staff from the time of arrival at the airport until their departure including to their respective hotels, BMICH and back and other places where the evening functions were held.</p> <p>It is imperative that a conference of this magnitude facilitates the provision of healthcare to meet any exigencies that may arise during the Conference. Since the BMICH did not have an Emergency Health Center as Conference Organizer, it was the responsibility of the SEC to provide same.</p> <p>The Conference was held during peak hours and the SEC could not afford to take any chances with regard to traffic congestions and unavoidable delays that may lead to any unfortunate incidents.</p> <p>Previous IOSCO Annual Conferences held in Korea, Istanbul and Jordan too had the said facility.</p> <p>In light of the IOSCO Conference the SEC decided to select a greeting card (out of the quotations received) that depicted the rich culture of Sri Lanka in order to attract foreign participants and to promote the Country. The selected card blended with the Sri Lankan Flag and the IOSCO logo that was printed on the greeting card, which conveyed a message that the IOSCO conference will be held in Sri Lanka in the year 2005. Since the lowest quote did not depict such portrait, it was rejected.</p>
<p>3.3 Idle and under utilized assets</p> <p>(a) The Access Control System installed in the office premises of the Commission spending a sum of Rs 690,862/- had been abundant at the end of the previous year as the Commission had an opinion that it did not serve any useful purpose.</p>	<p>The Commission wrote to the Government valuer by letter Ref: SEC/FAD/05/06/415 dated 2nd June 2005 seeking a valuation to dispose the Access Central System. The Secretariat as at date (24.01.2006) did not receive a response although constant reminders were sent via the telephone and in writing by letter Ref: SEC/FAD/05/11/771 dated 28th November 2005.</p>



Responses of the Commission ... *Contd*

Auditor General's Observations	SEC Responses
<p>3.4 <u>Transaction of a Contentious Nature</u></p> <p>All the expenses including the economic class of air fair for the participation of one of the Commission members for the programme held in Dhaka in Bangladesh had been reimbursed by the International Financial Corporation (IFC). However this Commission member had traveled on business class and the additional cost of the air ticket of Rs 40,899/- had been borne by the SEC.</p>	<p>From the inception the Members of the Commission had been traveling business class for official purposes. Therefore the economy class ticket issued by International Financial Corporation was upgraded for the Member of the Commission to travel.</p>
<p>3.5 <u>Corporate plan</u></p> <p>The Commission had not prepared a Corporate Plan for the year 2005 and onwards in terms of Section 5:1:3 chapter 5 of the Public Enterprises Circular No PED/12, to incorporate strategies regarding the future direction of the Commission.</p>	<p>Noted your comment. The SEC had a very clear direction in the year under review although a written Corporate Plan was not available. The Members of the Commission approved the Budget for the year 2005. Other than the routine regulatory work carried out by the Commission following key areas of work and other initiatives undertaken during the year.</p> <p>The IOSCO Conference was organized and concluded with resounding success for around 375 delegates representing about 86 countries.</p> <p>Facilitated formulation of rules for five new categories of Market Intermediaries.</p> <p>Reviewed the Take Overs and Mergers Code with the assistance of Stake Holder Committee specially constituted for this purpose. The new revised revision is expected to be finalized shortly.</p> <p>With a view to facilitating public trading of securitized bonds the SEC carried out an initial review of the legal framework. This review was followed by identification of the options available in addressing lacunas in a subsisting regulatory framework.</p> <p>Consultations were held with a joint committee constituted by the Institute of Chartered Accountant of Sri Lanka and the SEC with a view to mandating rules on good Corporate Governance for listed companies.</p> <p>A Consultant was appointed by the SEC to conduct a study on the Debt Market in Sri Lanka with a view to facilitating the developments of Debt Market.</p> <p>Studied the issue of Demutualization and identified substantive amendments required to the SEC act to enable the licencing of Demutualization of Stock Exchanges.</p> <p>Commenced a study with a view to identify the regulatory structure required to be put in place to support the Derivative Market in Sri Lanka.</p> <p>Supported the CSE in the development of a regulatory framework for facilitating the creation of a Secondary Market in government debt.</p>

**Responses of the Commission ... Contd**

Auditor General's Observations	SEC Responses
<p>3.6 <u>Activities of the Commission</u></p> <p>(a) Publication of the fourth edition of the Booklet on the Securities Market in Sri Lanka authored by a leading professional which was identified as a core function of the Commission was only an updated publication of the third edition of the same booklet. However, this also had not been completed even after end of the year under review.</p> <p>(b) There were some instances of acquiring substantial interest in share ownership of certain Commercial Bank by some shareholders through the subsidiaries and associated companies under their conglomeration. It was observed in audit that by this trend it was not much benefited to the economy of the country as well as to the position of the SEC as it is the regulatory body in the share market.</p>	<p>Creating public awareness is one of the main objectives of the Commission. Publication of the 4th Edition (Sinhala version) of the Booklet on the Securities Market in Sri Lanka Authored by Prof. Lalith Samarakoon was initiated by the Commission in light of the amended SEC Act with new developments such as market intermediaries, debt market ect. This publication is currently used as a text in the advanced level curriculum and it is the duty of the SEC to create awareness to promote knowledge sharing at school level.</p> <p>The booklet is an update as at June 2005 and information had to be collected and submitted to the Author on his request. The author at the time of the revised edition was stationed in the United States. These changes had to be submitted by the Secretariat to the Author who was attached to the Minnesota University in the United States. Several proofs were carefully made and sent from Sri Lanka to the United States and vice versa.</p> <p>The booklet was printed in the latter part of December 2005. A copy is forwarded for your reference.</p> <p>Market manipulation is defined as an offence under the SEC Act. However the circumstance outlined by you does not give rise to market manipulation. The issues out-lined relates to the ceiling imposed under the Banking Act with a view to ensuring share ownerships in licenced commercial banks, is not concentrated enabling control by a single shareholder or group of connected shareholders or parties.</p> <p>The SEC is not vested with powers to enforce compliance of the provision of the Banking Act.</p> <p>In terms of rules 12 & 13 of Gazette Notification No 1215/2 dated 18th December 2001 published in terms of the SEC Act Market manipulation describe as follows.</p> <p>Rule 12. No person shall create, cause to be created or do anything that is calculated to create a false or misleading appearance or impression of active trading, or a false or misleading appearance or impression with respect to the market for or the price of any securities listed in a licensed stock exchange.</p> <p>Rule 13. No person shall by means of purchase or sale of any securities that do not involve a change in the beneficial ownership of those securities, or by any fictitious transactions or by any other means, create a false market in any securities listed in a licensed stock exchange.”</p> <p>The SEC however considered the circumstances in making a determination that there has been no violation of the provisions of the Take Overs & Mergers Code.</p>
<p>4. <u>Systems and Controls</u></p> <p>Special attention is needed in respect of the following areas of control.</p> <p>a) Usage of Telephone.</p> <p>b) Nomination for the foreign training.</p>	<p>Due care will be taken.</p> <p>Nominations for foreign training approval are decided by the Board after taking into consideration the training needs of the Officer.</p>

