



Regulatory Activity Report for the year 2023

This report aims to enhance the awareness of the preparers of financial statements as well as of their auditors on the nature and type of deviations observed by SLAASMB in ascertaining compliance with Sri Lanka Accounting Standards and Sri Lanka Auditing Standards as SLAASMB's contribution towards enhancing the reliability and quality of the financial reporting in the country.

1. Introduction of SLAASMB

1.1 Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)

The Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB), established under the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 is the independent accounting and auditing regulator in the country. In discharging the functions under the statute, SLAASMB's regulatory activities include reviewing financial statements of economically significant entities termed as Specified Business Enterprises (SBEs) for compliance with the Sri Lanka Accounting Standards (SLASs) and inspecting their audits for compliance with Sri Lanka Auditing Standards (SLAuSs) and taking enforcement actions based on the severity of the findings. SLAASMB has identified 1,707 SBEs as at 31 December 2023 and the timely submission of the annual audited financial statements of these SBEs to SLAASMB is the responsibility of the management of such SBE.

Being in active operations for over two decades, SLAASMB has induced SBEs and auditors to perform their roles maintaining a high level of compliance with SLASs and SLAuSs, which results in enhancing the reliability of the financial reporting in the country and increasing investor confidence while contributing towards the development of the capital market.

The Act requires the SBEs to submit their audited annual financial statements as well as any information requested to SLAASMB to enable SLAASMB to monitor compliance with Sri Lanka Accounting Standards.

Based on the severity of the findings, SLAASMB takes different enforcement mechanisms in line with Act No. 15 of 1995 and takes all possible measures to contribute towards the financial reporting environment in Sri Lanka with the ultimate aim of enhancing the reliability of the financial reporting in the country.

2. Regulatory activities performed by SLAASMB during the year

2.1 Review of financial statements

2.1.1 How we selected financial statements for review

When selecting financial statements for review to ensure effective coverage is made in regulating financial statements for compliance with SLASs during the year, SLAASMB adopted a mixed model as in the previous year, combining a risk-based approach with random and rotation approaches. It also considered public accountability of the entities to select high-risk entities.

Reviews under the risk-based approach were conducted on pre-determined themes based on industry-focused risk criteria. This theme focus review approach enabled SLAASMB to focus in to greater-depth on specific aspects of SLASs that paved way to identify aspects that are important for a high quality corporate reporting.

Key themes focused during the year were;

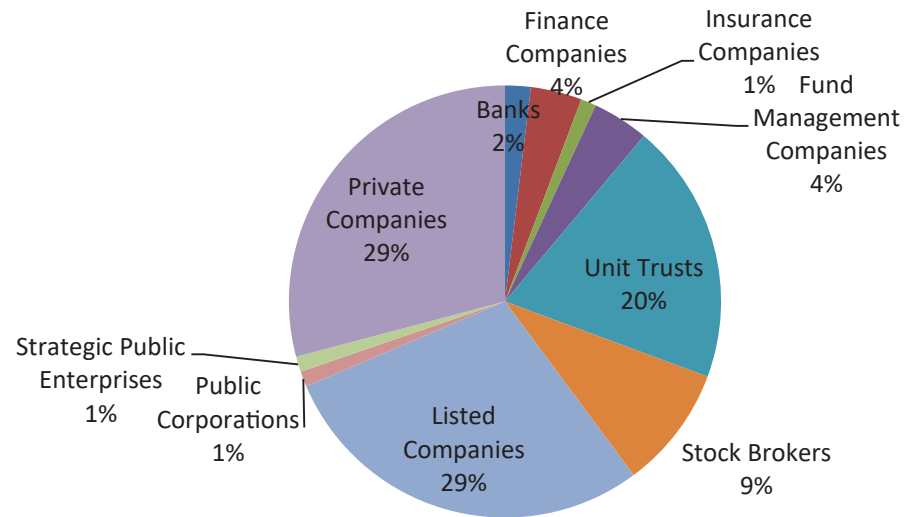
- Recognition, measurement and disclosures in relation to impairment of property, plant and equipment

- Fair value measurement and related disclosures by companies in the real estate sector
- Presentation of cash flow statement
- Liquidity disclosures
- Tax disclosures
- Measurement and disclosures in relation to consumable biological assets.

2.1.2 Coverage of Financial Statement Reviews during 2023

SLAASMB completed reviews of 261 sets of financial statements relating to 261 SBEs during the year, compared to the 541 sets of financial statements relating to 534 SBEs completed during 2022. The 52% decline in the numbers reviewed during the year is seen as a direct consequence of the low number of inspection staff served during the year due to 83% of such staff positions being vacant at the end of the year, arising from the difficulties in attracting professional staff as a result of salary constraints.

Sectoral representation of the financial statement reviews completed is depicted in the below graph;



2.1.3 .Results of monitoring compliance with Sri Lanka Accounting Standards (SLFRS/LKAS)

Summary of Findings from reviews	Financial Statements	
	No.	%
Compliant	192	74%
Compliant with Observations made	66	25%
Non-compliant: Undertakings were obtained	2	1%
Non-compliant: Issued Warnings	-	-
Non-compliant: Legal action Instigated	1	-
	261	100%

2.1.3.1 Compliant with observations made

Departures from SLFRSs/LKASs detected, which were material, but did not require the use of procedures using statutory provisions, were informed to SBEs as observations, by letters of assistance, so that the SBEs could, where necessary, improve on the compliance, on their own in the future.

The main findings on the review of financial statements are as follows;

Area of observation	Financial Reporting Deficiency	Standards Requirement
<p>True and fair view of the financial statements Section 6(1) of the SLAAS Act No. 15 of 1995</p>	<p>Not preparing financial statements in compliance with SLFRSs/LKASs and not taking all necessary measures to ensure that the financial statements are audited in accordance with Sri Lanka Auditing Standards with the object of presenting a true and fair view of the financial performance and financial condition.</p>	<p>All SBEs should prepare financial statements in compliance with SLFRSs/LKASs and take necessary measures to ensure that the financial statements are audited in accordance with Sri Lanka Auditing Standards with the object of presenting a true and fair view of the financial performance and financial condition.</p>
<p>Risks arising from financial instruments SLFRS 7: Paragraph 31 to 42</p>	<p>The nature and extent of risks arising from financial instruments to which the entity is exposed, and quantitative and qualitative information about the amounts arising from expected credit losses, have not been adequately disclosed at the end of the reporting period.</p>	<p>An entity shall disclose information that enables users of financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.</p> <p>The disclosures required by paragraphs 33-42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk.</p>

Area of observation	Financial Reporting Deficiency	Standards Requirement
Recognition of expected credit losses SLFRS 9: Paragraph 5.5.1	Loss allowance for expected credit losses on financial assets that are measured at amortized cost has not been recognized, irrespective of existence of objective evidence	Entity needs to recognize a loss allowance for expected credit losses on a financial asset that is measured at amortised cost or at fair value, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply
Fair value hierarchy and the fair value measurement disclosures SLFRS 13: Paragraph 93	Disclosures relating to valuation techniques used, inputs to the valuation techniques, quantitative information about significant unobservable inputs used, significant adjustments made to the inputs and the fair value hierarchy for each class of assets and liabilities measured at fair value, have not been adequately made .	Entity recognizing assets and liabilities at fair values need to disclose, at a minimum, the fair value hierarchy for each class of assets and liabilities measured at fair value and where fair value measurements are categorised within level 2 and 3, the valuation techniques and inputs used in fair value measurement and for fair value measurements categorised within level 3, the quantitative information about significant unobservable inputs used and significant adjustments made to those inputs.
Performance obligations to customers SLFRS 15: Paragraph 119	Information on the performance obligations relating to the contracts with customers such as details as to when performance obligations had been typically met, significant payment terms, nature of goods / services promised, return / refund obligations and types of warranties etc. have not been sufficiently disclosed	Entity needs to disclose following information of its performance obligations relating to the contracts with customers; <ul style="list-style-type: none"> a) when it satisfies its performance obligation, b) significant payment terms, c) nature of goods/services promised, d) return/refund obligations and e) types of warranties etc.
Effects that leases have on lessees SLFRS 16: paragraph 51	Information to assess the effect that leases may have on the financial position, financial performance and cash flows of the lessee has not been sufficiently disclosed	Lessees shall disclose the information to assess the effect that the leases have on the financial position, financial performance and cash flows of the lessee.

Area of observation	Financial Reporting Deficiency	Standards Requirement
Basis of preparation of the financial statements and accounting policies LKAS 1: paragraphs 112 and 117	Adequate disclosures in relation to the basis of preparation of the financial statements and the specific accounting policies and/or significant accounting policies that comprise of the measurement bases and other accounting policies relevant for an understanding of the financial statements have not been made.	Notes to the financial statements needs to present information about the basis of preparation of financial statements, information relevant to understand the said financial statements and information relating to significant accounting policies
Tax reconciliation LKAS 12: paragraph 81	Adequate disclosure of the relationship between tax expense and accounting profit has not been made	Entity needs to provide an explanation of the relationship between tax expense and accounting profit.
Tax losses LKAS 12: paragraph 82	Evidence to support the recognition of deferred tax assets arising due to tax losses has not been made.	Entity needs to provide the nature of evidence to support the recognition of deferred tax assets arising due to tax losses.
Recognizing deferred tax assets and liabilities LKAS 12: paragraphs 15, 24, 34 and 48	Not considering all taxable temporary differences when recognizing deferred tax liabilities or recognizing deferred tax assets, in relation to carried forward tax losses irrespective of the extent of future taxable profits available to utilize the unused tax losses .	<p>A deferred tax liability shall be recognized for taxable temporary differences and a deferred tax asset shall be recognized for deductible temporary differences to the extent of its utilization.</p> <p>A deferred tax asset shall be recognized for the carry forward of unused tax losses to the extent that future taxable profits are available to utilize such unused tax losses.</p>
Disclosures for revalued Property Plant and Equipment (PPE) LKAS 16: paragraph 77	Disclosure of all relevant information relating to the revaluation of PPE has not been made.	When PPE are stated at revalued amounts, the following disclosures need to made: <ol style="list-style-type: none"> a) effective date of the revaluation; b) whether an independent valuer was involved; c) carrying amount under the cost model for each revalued class of PPE; d) revaluation surplus, change for the period and restrictions on the distribution to shareholders

Area of observation	Financial Reporting Deficiency	Standards Requirement
Review the useful life of an asset LKAS 16: paragraph 51	Useful life of an asset have not been reviewed at least at each financial year-end.	Useful life of an asset shall be reviewed at least at each financial year-end and if expectations differ, the changes shall be accounted for as a change in an accounting estimate.
Disclosures on Related Parties LKAS 24: paragraph 18	Adequate disclosure relating to the nature of the related party relationships as well as information about the transactions with related parties have not been made.	For related party transactions, the entity shall disclose the nature of the related party relationship, information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements

2.1.3.2 Non-compliant: Undertakings obtained

Based on the materiality of the findings on deviations from SLFRSs/LKASs, SLAASMB obtained undertakings from two SBEs, ie., a Public Corporation and an SBE which is listed in Colombo Stock Exchange to make the corrections in their subsequent set of financial statements.

Types of items for which the undertakings were obtained are as follows;

SLAS / Act Reference	Non-compliance	Standards Requirement	Undertaking
Recognition and measurement of financial assets SLFRS 9 Financial Instruments: Paragraph 7.1.1	Failed to apply recognition and measurement of financial assets	Should recognize all the financial assets and measure them as per SLFRS 9	Undertook to apply the requirements of SLFRS 9 and to adjust the comparative information in relation to the application of SLFRS 9 as required by Sri Lanka Accounting Standard LKAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, in the next financial statements
Disclosures on Financial Instruments SLFRS 7 Financial Instruments: Disclosures: Paragraph 4	Failed to disclose relevant information as per the standard	Need to make the relevant disclosures as per SLFRS 7	Undertook to apply the requirements of SLFRS 7 and to adjust the comparative information in relation to the application of SLFRS 7 as required by Sri Lanka Accounting Standard LKAS 8, in the next financial statements
Maintain accounting records and provide information to the auditors Section 6(1) of the SLAAS Act No. 15 of 1995	Failed to maintain proper accounting records and to provide the information required for the auditor to conduct the audit of the financial statements. The auditor has expressed a disclaimer of opinion on the said financial statements.	Prepare accounts of SBE in compliance with SLASs and take necessary measures to ensure that accounts are audited in accordance with SLAuSs with the object of presenting a true and fair view of the financial performance and financial condition.	Undertook to rectify all matters referred to in the basis for the disclaimer of opinion in the auditor's report, and to incorporate all necessary resulting adjustments together with relevant disclosures and to reflect in the next financial statements.

2.1.3.4.Non-compliant: Legal actions Instigated

A Company listed in the Colombo Stock Exchange engaged in providing financial services had failed to maintain proper books of accounts for the year ended 31 March 2021 as required by section 6 (1) of the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 and their auditor had expressed a disclaimer of opinion on the said financial statements.

SLAASMB observed that the Company had published incomplete and erroneous information in the said financial statements failing to present a true and fair view of the financial performance and financial position of the company for the year ended 31 March 2021 and that the financial statements for the years ended 31 March 2022 and 2023 had not been finalized and the Company had not been able to appoint an auditor.

SLAASMB has referred this to the Attorney General for the next course of action to be taken against the Company and/or the directors of the Company on failure to prepare and present financial statements giving a true and fair view of the financial performance and financial condition of the Company for the year ended 31 March 2021.

2.2 Inspection of audits of SBEs

2.2.1 How we selected audits to inspect

The inspections of the audits of SBEs are carried out with the overall objective of enhancing the audit quality in the country. In doing so, audits are selected for inspection through a risk-based approach as well as a random selection approach.

Amidst the slow and steady recovery of the Sri Lankan economy which encountered significant uncertainties in 2022-2023, SLAASMB as the sole audit regulator in the country, acknowledged the effect of the uncertainties surrounding the businesses and the difficulties they pose in making precise judgments and estimates. These uncertainties increase the risk involved in auditing accounting estimates while requiring the auditors to be more skeptical in their approaches and require a significant amount of professional judgment to be exercised and to be focused on ethical responsibilities when carrying out the audits.

Accordingly, SLAASMB based the selection of audits for inspection during the year on a mixed model where the risk-based approach was combined with a random sampling approach.

Special focus areas during the conduct of audit inspections;

- Accounting estimates in relation to individual assessment of impairment of loans and advances of banks.
- Identification and assessment of the risk of material misstatements through understanding the entity and its environment and responses to assessed risks.
- Accounting estimates in relation to valuation of investment properties of listed companies.
- Premium income and use of experts in relation to insurance contract liabilities of insurance companies.

In addition, certain audit inspections were carried out to assess the professional judgment and skepticism exercised by the auditors when conducting the audits of financial statements.

2.2.2 Coverage of Audit Inspections during 2023

During the year, 16 audits carried out by 6 firms of practicing Chartered Accountants were inspected, compared with the 33 audits carried out by 9 firms that were inspected during the preceding year.

The decline in the number of inspections is attributed to the reduced number of inspection staff available at SLAASMB as detailed in 2.1.2 above. 15 of the audits inspected during the year were carried out by 5 firms that are members of international networks.

2.2.3 Results of monitoring compliance with Sri Lanka Auditing Standards (SLAuSs)

Summary of Findings from Audit Inspections	2023	
	No. of Inspections	No. of audit firms
Compliant	13	5
Compliant with observations	3	3

Based on the severity of the observations made during the inspection of audits, SLAASMB adopts diverse measures in its attempt to make the auditors improve themselves, in achieving SLAASMB's objective of improving the audit quality environment of Sri Lanka.

Based on the findings from the inspections, 13 audits were compliant with SLAuSs in respect of the areas focused on the inspections. The findings of the balance 3 inspections did not require further action under the statute and the said findings were communicated to the respective auditors by letters of observation. In comparison 9 audits relating to which observations were communicated in respect of deficiencies were conducted by 5 audit firms during 2022.

2.2.3.1 Compliant with Observations made

When non-compliances with SLAuSs are observed during regular audit inspections that do not require further action under the statute, such deficiencies are communicated to the audit firm by a letter of assistance termed “Letters of Observations”.

The main findings from audit inspections for which Letters of Observations were are as follows

Audit area	Audit deficiency	Standards Requirement
Risk assessment	<p>The deficiencies in performing risk assessment procedures included the following.</p> <ul style="list-style-type: none"> • Adequate understanding of the entity and its environment had not been obtained to perform a comprehensive identification and an assessment of the risks of material misstatement. • A comprehensive risk assessment had not been performed. • Adequate audit procedures had not been performed to identify the risks of material misstatements due to fraud. 	<p>The auditor is required to perform risk assessment procedures to identify and assess the risks of material misstatements through an understanding of the entity, and its environment including the entity’s internal controls, enabling the auditor to provide a basis for designing and implementing responses to the assessed risks of material misstatement.</p>
Auditor’s responses to assessed risks	<p>The deficiencies relating to the auditor’s responses to the assessed risks are</p> <ul style="list-style-type: none"> • When deviations from the controls have been detected during the testing of the operating effectiveness of controls, the auditor had not made sufficient inquiries to understand the deviations and their potential consequences before relying on such controls. 	<p>The auditor is required to design and implement appropriate responses to address the assessed risk of material misstatements in order to obtain sufficient appropriate audit evidence.</p>

Audit area	Audit deficiency	Standards Requirement
	<ul style="list-style-type: none"> • When information has come to the attention of the auditor that indicates certain controls are not operating effectively, the auditor has not ascertained the necessity to revise the risk assessment and modify the planned procedures. • An appropriate cut-off testing on revenue had not been performed focusing on different series of invoices generated for different types of revenue. • Adequate audit procedures had not been performed to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory as of the reporting date. • The details of the sample of the sales invoices verified has not been documented in the audit working file. • The external confirmation procedures to obtain audit evidence had not been performed by the auditor in relation to the bank balances, interest-bearing loans, and lease balances. 	
Audit Evidence	Sufficient appropriate audit evidence had not been obtained by the auditor by performing audit procedures relating to trade receivables, purchases, related party balances and interest-bearing loans and borrowings.	The auditor is required to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Audit area	Audit deficiency	Standards Requirement
Audit of accounting estimates	<p>Instances of the auditor failing to perform adequate audit procedures relating to accounting estimates are;</p> <ul style="list-style-type: none"> • The competence, capabilities and objectivity of the management's expert and the appropriateness of the management's expert's work had not been evaluated. • Reasonableness of the assumptions used in arriving at the fair values of the assets had not been evaluated. 	<p>The auditor is required to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework</p>
Communication with Those Charged with Governance (TCWG)	<p>The deficiencies in relation to the communications the auditor has had with TCWG are;</p> <ul style="list-style-type: none"> • Adequate communication had not been made with TCWG regarding the going concern of the entity when events or conditions that may cast significant doubt on the entity's ability to continue as a going concern had been identified. • The auditor having effective two-way communication with TCWG was not evident in the audit documentation. 	<p>The auditor is required to communicate the responsibilities of the auditor in relation to the financial statements and audit, to provide an overview of the planned scope and timing of audits, and to provide timely observations significant and relevant to their responsibility to oversee the financial reporting process and to promote an effective two-way communication between the auditor and TCWG</p>
Going concern	<p>Deficiency in relation to the evaluation of the appropriateness of management's use of going concern basis of accounting in the preparation of financial statements is as follows;</p> <ul style="list-style-type: none"> • Failure to evaluate the adequacy of disclosures made in the financial statements relating to going concern ability of the entity when events or conditions have been identified without the existence of material uncertainties. 	<p>The auditor is required to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern and to determine the implications for the auditor's report.</p>

2.2.3.2 Non-compliant: Legal actions Instigated

SLAASMB issued a direction requesting an investment holding company to re-audit the financial statements for the year ended 31 March 2016 as the auditor had issued an unqualified opinion when the Company had failed to maintain proper books of accounts and related records. The Company was not willing to bear the additional costs of a re-audit.

In response, SLAASMB having observed the continuous violation of the Auditing Standards by the said auditor and failure by the said auditor to address the matters communicated by SLAASMB in the audit of the subsequent year's financial statements, has taken measures to instigate legal action against the Auditor and the Company, and has referred the matter to the Attorney General.

2.3 Measures taken to enhance the audit quality

SLAASMB considers audit quality as a key factor in building public confidence in financial reporting environment and has taken the following measures to enhance the audit quality of the country.

2.3.1 Communicated suggestions for improvements

With the aim of improving the audit quality, suggestions for improvements were communicated relating to three audit engagements carried out by three audit firms during the year. The auditor is expected to improve on these suggestions when conducting their audits in the future.

Suggestions for improvements communicated included the following;

- Improve the audit documentation to understand the nature, timing and extent of the audit procedures performed.
- Focus on the characteristics of fraudulent journal entries or other adjustments processed outside the normal course of business during the testing of journal entries.

- Obtain sufficient appropriate audit evidence in relation to the related company's ability to provide continuous financial support by evaluating the financial position and performance of such related company through reliable information sources.
- Evaluate the reliability of underlying data used in the preparation of forecasts by the management and determine whether the assumptions underlying the forecasts are adequately supported by comparing the forecasted data with the latest results.
- Evaluate the appropriateness of accounting policies adopted by the Company in the context of its business activities

2.3.2 Communicating Findings of audit inspections to Audit Committees

Audit Committee forms a part of Those Charged with Governance (TCWG), and are vested with the responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. Accordingly, the Audit Committee plays a significant role in ensuring the quality of the financial reporting process of a company and in maintaining appropriate relationships with the auditor.

SLAASMB continues to recognize the contribution of the Audit Committees as TCWG towards enhancing the quality of the financial reporting and the audit environment. Accordingly, SLAASMB continued to communicate the outcome of the audit inspections to the Chairs of the Audit Committees of companies listed on the Colombo Stock Exchange to foster effective oversight of financial reporting.

2.3.3 Communicating Findings of audit inspections to stakeholders of SLAASMB

SLAASMB identifies the preparers of financial statements, auditors, peer regulators, government of Sri Lanka and the general public as its stakeholders. By enhancing the knowledge of the stakeholders SLAASMB leads the pathway in achieving its objective of enhancing reliability of the financial reporting in Sri Lanka.

Accordingly, SLAASMB with the collaboration of the CA Sri Lanka, the Accounting and Auditing standards setter and the licensing authority of the auditors, conducted a session for its stakeholders to share the common findings SLAASMB has encountered during the audit inspections carried out during the recent years. SLAASMB expects to continue the sharing of findings with its stakeholders to educate the auditors who conduct audits of SBEs as well as members of the Audit Committees who are expected to have effective communication with the auditor.

